

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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**REPORT ON THE AUDIT OF  
FINANCIAL STATEMENTS IN ACCORDANCE  
WITH OMB CIRCULAR A-133**

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**YEAR ENDED SEPTEMBER 30, 2004**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

YEAR ENDED SEPTEMBER 30, 2004

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**INDEPENDENT AUDITORS' REPORT  
AND FINANCIAL STATEMENTS  
AND ADDITIONAL INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2004**

## INDEPENDENT AUDITORS' REPORT

Honorable Joseph J. Urusemal  
President  
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2004, which collectively comprise the FSM National Government's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the FSM National Government. Our responsibility is to express an opinion on the respective financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the FSM National Government's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Because of inadequacies in the accounting records, we were unable to form an opinion regarding the amount at which cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments are recorded for the governmental activities and the General Fund; the amount at which receivables and amounts due to the FSM State Governments are recorded for the U.S. Federal Grants Fund and the aggregate remaining fund information; and the amount at which cash and cash equivalents and receivables are recorded for the Asian Development Bank Loan Fund. These amounts enter into the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information for the year ended September 30, 2004.

The financial statements of the National Fisheries Corporation, a component unit of the FSM National Government, reports its investment in Micronesia Longline Fishing Company, a 97%-owned corporation, and its investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., all 50%-owned corporations, at cost. Accounting principles generally accepted in the United States of America requires investments to be adjusted to reflect the National Fisheries Corporation's equity in the losses of those corporations, which would decrease the investment, decrease net assets, and change the expenses of the aggregate discretely presented component units. Due to the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., the amount by which this departure would affect investments, net assets, and expenses of the aggregate discretely presented component units is not reasonably determinable.

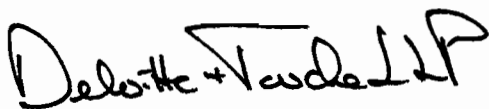
The financial statements of the National Fisheries Corporation have not been audited, and we were not engaged to audit these financial statements as part of our audit of the FSM National Government's basic financial statements. The financial activities of the National Fisheries Corporation are included in the FSM National Government's basic financial statements as a discretely presented component unit and represent 2% and 10% of the assets and revenues, respectively, of the FSM National Government's aggregate discretely presented component units.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had accounting records regarding cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information, been adequate, as discussed in the third paragraph above, the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., as discussed in the fourth paragraph above, and the lack of audited financial statements of the National Fisheries Corporation, as discussed in the fifth paragraph above, such financial statements, as set forth in Section II of the foregoing table of contents, present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the FSM National Government as of September 30, 2004; and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, on pages 4 through 10, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 47 and 48, are not a required part of the basic financial statements but are supplementary information required by GASB. This supplementary information is the responsibility of the management of the FSM National Government. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the FSM National Government's respective financial statements that collectively comprise the FSM National Government's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the FSM National Government, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the FSM National Government. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effects of the matter discussed in the third paragraph above, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 14, 2006, on our consideration of the FSM National Government's (Primary Government only) internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

August 14, 2006



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
September 30, 2004

This discussion and analysis of the National Government's financial performance provides an overview of the financial activities of the National Government for the year ended September 30, 2004 and of the financial position of the National Government at September 30, 2004. This report is to be read in conjunction with the financial statements of the National Government which begin on page 11. Fiscal Year 2003 comparative information has been provided where appropriate.

The Management's Discussion and Analysis (MD&A) has been a requirement of the Governmental Accounting Standards Board (GASDB) since FY03.

### **FINANCIAL HIGHLIGHTS**

- For the fiscal year ended September 30, 2004, FSM National Government has primary total net assets of \$66,873,262 (FY03 \$65,508,518). The increase is primarily attributable to an increase in local revenues.
- During the year, National Government expenses for governmental activities were \$48,250,245 (FY03 \$56,248,566) and were funded by program revenues of \$24,893,872 (FY03 \$26,321,979) and further funded with taxes and other general revenues that totaled (net of special items) \$24,721,117 (FY03 \$27,822,617).
- The net change in governmental fund balance is \$3,649,446 (FY03 \$1,378,233). Total revenues reported are \$50,288,189 with total expenditures of \$47,725,472. Total loan proceeds from ADB is \$1,086,729.
- At September 30, 2004, the General Fund reported an unreserved fund deficit of \$1,264,491 as compared from FY03 with an unreserved deficit of \$2,410,559.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This Financial Statements for the Year Ended September 30, 2004 consists of four parts - management's discussion and analysis (this section), the basic financial statements, required supplementary information, and notes to financial statements.

The basic financial statements include two kinds of statements that present different views of the National Government.

#### The Government-Wide Financial Statements

The government -wide financial statements report information about the National Government as a whole using accounting method similar to those used by the private-sector companies. It provides both long-term and short-term information about the government's financial status.

The Statement of Net Assets includes all of the Government's assets and liabilities. The difference between the two is called net assets. Overtime, increases or decreases in the Government's net assets serve as an indicator to measure the Government's financial position.

The Statement of Activities, on the other hand, accounts for the National Government's current year's revenues and expenses regardless of when cash is received or paid.

The Statement of Net Assets and the Statement of Activities are divided into three activities:

- **Governmental Activities** - Most of the National Government's basic services are reported here. These include the services provided by the Executive Branch such as health, education, foreign affairs, transportation, resources and development, finance, the Attorney General's office, and general administration; the Judicial Branch; the Legislative Branch; other National Government programs; Boards and Commissions; and other legislative appropriations. These services are funded by Compact of

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Management's Discussion and Analysis  
September 30, 2004

association funds, US Federal contributions, FSM revenue sharing, taxes and licenses, and investment income.

- Components Units – The National Government has six (6) component units namely, College of Micronesia - FSM, National Fisheries Corporation, FSM Telecommunications Corporation, FSM Development Bank, FSM Social Security Administration and the Coconut Development Authority. These components units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government is such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete.

Fund Financial Statements

The analysis of the National Government's major funds begins on page 13. The Fund Financial Statements provide detailed information about the most significant funds - not the National Government as a whole. Some funds are required to be established by FSM law. However, the National Government establishes many other funds to help it control and manage money for particular purposes to show that it meets the legal responsibilities for using certain taxes, grants, and other money (like grants received from outsiders). The National Government has two kinds of funds - government and fiduciary – each using different accounting approaches.

- Government funds - Most of the National Government's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The government fund statements provide a detailed short-term view of the National Government general operations and the basic services it provides. Government fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the National Government's program. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in a reconciliation at the bottom of the page 13.
- Proprietary funds - These funds are used to account for assets held by a Government unit in a trustee capacity for individuals, private organizations, and other governmental resources. This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that costs (expenses, including amortization and depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

**THE NATIONAL GOVERNMENT AS A WHOLE**

Net assets may serve over time as a useful indicator of government's financial position. At the end of FY04, National Government assets exceeded liabilities by \$66,873,262. Of the total net assets, \$23,366,526 are restricted as to purposes for which they may be used. National Government uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although National Government investments in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other source, since the capital assets themselves cannot be used to liquidate these liabilities.

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NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
September 30, 2004

Table 1 shows the schedule of National Government's net assets as of September 30, 2004.

Table 1  
Net Assets

	<u>2004</u>	<u>2003</u>
Current assets	\$ 56,002,022	\$ 60,419,458
Other assets	43,707,639	36,026,178
Capital assets	<u>19,913,680</u>	<u>21,251,370</u>
Total assets	119,623,341	117,697,006
Current liabilities	17,570,239	17,963,368
Other liabilities	<u>35,179,840</u>	<u>34,225,120</u>
Total liabilities	<u>52,750,079</u>	<u>52,188,488</u>
Net assets:		
Invested in cap assets net of related debt	19,913,680	21,251,370
Restricted	23,366,526	28,819,488
Unrestricted	<u>23,593,056</u>	<u>15,437,660</u>
Net assets	<u>\$ 66,873,262</u>	<u>\$ 65,508,518</u>

At the end of FY04, National Government unrestricted assets show a surplus of \$23,593,056 as compared with \$15,437,660 at the end of FY03.

Table 2 shows the changes in Net Assets of the National Government for the year ended September 30, 2004.

Table 2  
Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Revenues:		
<i>Program Revenues:</i>		
Charges for services	\$ 5,694,442	\$ 5,106,365
Operating grants and contributions	18,699,430	18,231,773
Capital grants and contributions	500,000	2,983,841
<i>General Revenues:</i>		
Income tax	3,073,616	2,318,022
Compact funding	-	6,956,993
Fishing rights fees	12,067,418	11,817,041
Fuel tax	160,692	138,328
Import tax	2,840,467	1,949,024
Gross receipt tax	3,457,953	1,702,278
Investment earnings	2,910,243	2,811,904
Other	<u>883,928</u>	<u>129,027</u>
Total revenues	<u>50,288,189</u>	<u>54,144,596</u>

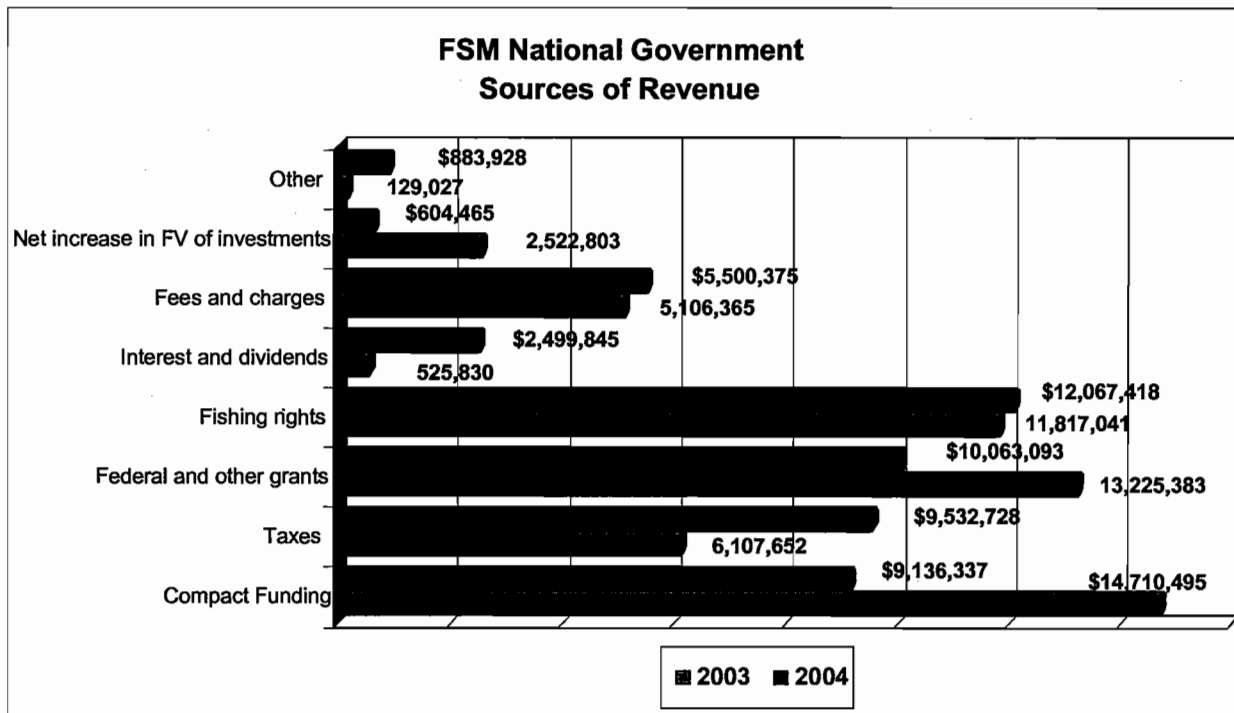
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Management's Discussion and Analysis  
September 30, 2004

Table 2, Continued  
Changes in Net Assets

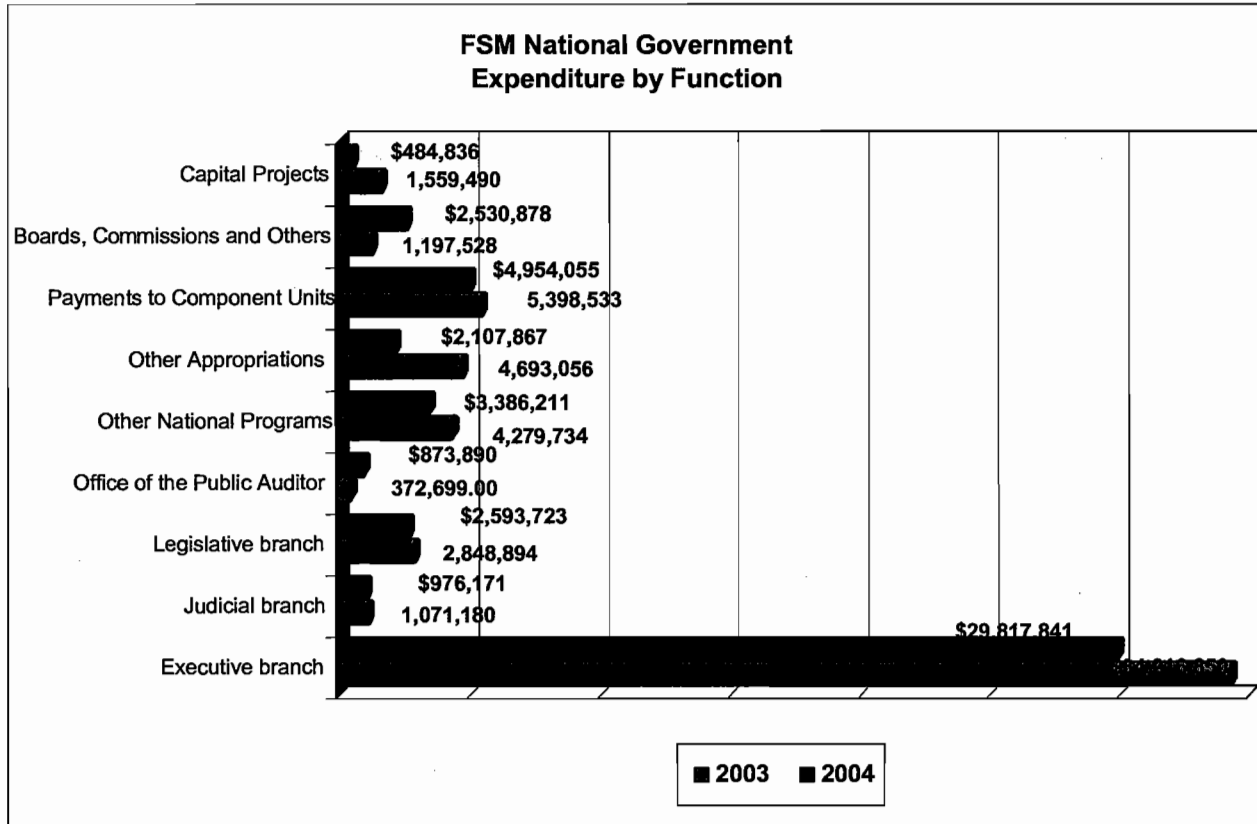
	<u>2004</u>	<u>2003</u>
Expenditures:		
Executive	30,415,454	34,912,672
Judicial	977,513	1,065,584
Legislative	2,728,787	3,079,869
Office of Public Auditor	840,903	367,912
Other Nat Gov Program	3,340,544	4,239,157
Boards and Commissions	2,553,577	1,181,729
Other Legis Approp	2,048,026	4,443,620
Payments to Component Units	4,954,055	5,398,533
Capital projects	391,386	1,559,490
Write-off of capital assets	<u>673,200</u>	<u>-</u>
Total expenditure	<u>48,923,445</u>	<u>56,248,566</u>
Change in net assets	1,364,744	(2,103,970)
Net assets, beginning of year	<u>65,508,518</u>	<u>67,612,488</u>
Net assets, end of year	<u>\$66,873,262</u>	<u>\$65,508,518</u>

National Government revenues from governmental activities, including local revenues, investment increases, and other grants funding totaled \$49,614,989 (FY03 \$54,144,596). In FY04, the cost of governmental activities totaled \$48,250,245 (FY03 \$56,248,566); the difference between the two representing an increase in net assets of \$1,364,744 (Decrease FY03 \$2,103,970). To assist in appreciating the details of governmental activities, the above governmental activities information is shown in pictorial form in the following graphs.



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Management's Discussion and Analysis  
September 30, 2004



**FINANCIAL ANALYSIS OF THE NATIONAL GOVERNMENT'S FUNDS**

Table 3 shows The National Governmental Fund changes in fund balances for the year ended September 30, 2004.

**Table 3  
Changes in Fund Balances**

	<u>General Fund</u>		<u>Other Funds</u>		<u>Total</u>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
<b>Revenues:</b>						
Compact funding	\$ -	\$ 6,956,993	\$ 9,136,337	\$ 7,753,502	\$ 9,136,337	\$14,710,495
Federal and other grants	-	-	10,063,093	13,225,383	10,063,093	13,225,383
Taxes	9,532,728	6,107,652	-	-	9,532,728	6,107,652
Fishing rights fees	12,067,418	11,817,041	-	-	12,067,418	11,817,041
Net increase in fair value of investments	604,465	2,522,803	-	-	604,465	2,522,803
Other	<u>3,455,878</u>	<u>880,449</u>	<u>5,428,270</u>	<u>4,880,773</u>	<u>8,884,148</u>	<u>5,761,222</u>
<b>Total revenues</b>	<u>25,660,489</u>	<u>28,284,938</u>	<u>24,627,700</u>	<u>25,859,658</u>	<u>50,288,189</u>	<u>54,144,596</u>
<b>Expenditures</b>	18,579,186	28,728,301	29,146,286	26,909,663	47,725,472	55,637,964
Excess of revenues over expenses	7,081,303	(443,363)	(4,518,586)	(1,050,005)	2,562,717	(1,493,368)
Net transfers	<u>(3,798,694)</u>	<u>(486,558)</u>	<u>4,885,423</u>	<u>3,358,159</u>	<u>1,086,729</u>	<u>2,871,601</u>
<b>Net change in fund balance</b>	<u>\$ 3,282,609</u>	<u>\$ (929,921)</u>	<u>\$ 366,837</u>	<u>\$ 2,308,154</u>	<u>\$ 3,649,446</u>	<u>\$ 1,378,233</u>

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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

Capital Assets

At the end of the September 30, 2004, FSM National Government had invested \$37,157,724 (FY03 \$38,719,890) in capital assets. These assets consist basically of office equipment and machinery, buildings, boats & ship, and motor vehicles. The summary of capital assets of the year is shown below:

	Primary Government Governmental Activities	
	<u>2004</u>	<u>2003</u>
Buildings	\$14,043,076	\$13,958,076
Ships and Boats	11,606,981	13,967,241
Computer Equipment	2,712,225	2,465,395
Aircraft	709,207	709,207
Furniture, Equipment and Machinery	2,888,810	2,738,813
Motor Vehicles	<u>5,197,425</u>	<u>4,881,158</u>
	37,157,724	38,719,890
Less accumulated depreciation	<u>(17,244,044)</u>	<u>(17,468,520)</u>
Total	<u>\$19,913,680</u>	<u>\$21,251,370</u>

Further information on the National Government's capital assets can be obtained from note 5 to the accompanying financial statements.

Long Term Debt

At the end of fiscal year 2004, National Government had long term debt of \$35,524,592 (FY03 \$34,577,580) relating to Governmental Activities as shown below:

	<u>2004</u>	<u>2003</u>
ADB Loan - Early Retirement	\$17,682,020	\$17,682,020
- Fisheries and Water Project	14,154,110	14,266,246
- Private Sector Development	2,949,307	1,962,578
- Basic social Services	100,000	-
Compensated Absences (Annual Leave)	<u>639,155</u>	<u>666,736</u>
	<u>\$35,524,592</u>	<u>\$34,577,580</u>

Further information on the National Government's long term obligations can be obtained from note 6 to the accompanying financial statements.

Economic Factors and Next year's Budget:

Fiscal year 2004 is the beginning of the implementation of the economic assistance under the Compact II/amended funding which replaces the funding sources from the Compact I. Under the amended Compact, annual funding will be available as follows:

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NATIONAL GOVERNMENT**

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- The education sector grant shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post secondary education
- The Health Sector grant shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services.
- The sector grant for private sector development shall support the efforts of the Federated of Micronesia to attract new foreign investment and increase indigenous business activity. Priorities will be in advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, and policies to foster private sector development, to facilitate investment by potential private investors, and develop business and entrepreneurial skills.
- The sector for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable and transparent national and local government and other public sector institutions and systems.
- The environment sector shall support the efforts of the Federated States of Micronesia to protect the national land and marine environment and to conserve and achieve sustainable use of its natural resources.
- Public Infrastructure grant shall give priority to primary and secondary education capital projects and programs that directly affect health and safety including water and waste water projects, solid waste disposal projects and health care facilities.

The local revenues and the revenue from fishing right fees are expected to be within a range of \$22-23 million. The added tax revenue of 20% resulting from the revised National/State tax sharing arrangements beginning January 2004 will generate an increase in tax revenue. The carry over balances from the Compact I may be authorized to be used to fund other operations of the Government.

**FINANCIAL CONTACT**

This financial report is designed to provide all interested users with a general overview of the National Government's finances. If you have questions about this report or need additional financial information, please contact the office of the Secretary of Finance and Administration, P.O. Box PS 158, Palikir, Pohnpei, FM 96941.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Net Assets  
September 30, 2004

	Primary Government	Component Units
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 2,228,827	\$ 16,587,480
Time certificates of deposit	-	105,231
Investments	20,888,416	8,782,450
Receivables, net	27,195,275	10,278,346
Due from component units	806,412	-
Due from primary government	-	180,045
Advances	4,566,960	170,398
Inventories	123,928	700,515
Other current assets	192,204	1,009,442
Total current assets	56,002,022	37,813,907
Noncurrent assets:		
Time certificates of deposit	1,149,850	-
Investments	8,159,955	11,707,900
Receivables, net	25,882,834	14,649,821
Capital assets, net of accumulated depreciation	19,913,680	56,823,498
Other noncurrent assets	-	287,005
Restricted assets	8,515,000	-
Total noncurrent assets	63,621,319	83,468,224
Total assets	\$ 119,623,341	\$ 121,282,131
<b><u>LIABILITIES</u></b>		
Current liabilities:		
Current portion of long-term debt	\$ 105,634	\$ 4,310,137
Accounts payable	4,968,637	2,607,098
Compensated absences payable	239,118	-
Other liabilities and accruals	4,173,904	2,061,724
Tax refunds payable	521,508	-
Due to FSM State Governments	7,486,080	-
Due to primary government	-	806,412
Deferred revenue	75,358	2,395,974
Total current liabilities	17,570,239	12,181,345
Noncurrent liabilities:		
Noncurrent portion of long-term debt	34,779,803	25,253,521
Compensated absences payable	400,037	-
Total noncurrent liabilities	35,179,840	25,253,521
Total liabilities	52,750,079	37,434,866
<b><u>NET ASSETS</u></b>		
Invested in capital assets, net of related debt	19,913,680	30,859,840
Restricted for:		
Future operations	8,515,000	-
Compact related	14,338,211	-
Capital projects	78,822	-
Other purposes	434,493	1,987,331
Unrestricted	23,593,056	51,000,094
Total net assets	66,873,262	83,847,265
Total liabilities and net assets	\$ 119,623,341	\$ 121,282,131

See accompanying notes to basic financial statements.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Statement of Activities  
Year Ended September 30, 2004**

	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
<b>Functions/Programs</b>						
<b>Primary government:</b>						
<b>Governmental activities:</b>						
President's office	\$ 958,684	\$ -	\$ 236,473	\$ -	\$ (722,211)	\$ -
External affairs and LNOs	3,205,280	-	-	-	(3,205,280)	-
Health, education and social affairs	15,429,258	4,156,624	9,557,826	-	(1,714,808)	-
Economic affairs	3,543,162	154,395	782,075	194,067	(2,412,625)	-
Transportation, communication and infrastructure	1,135,681	170,924	-	-	(964,757)	-
Finance and administration	2,667,440	84,174	1,446,332	-	(1,136,934)	-
Justice	2,907,962	445,476	1,269,818	-	(1,192,668)	-
Office of the Public Defender	567,987	-	-	-	(567,987)	-
Judiciary	977,513	-	641,500	-	(336,013)	-
Legislature	2,728,787	-	-	-	(2,728,787)	-
Office of the Public Auditor	840,903	-	842,299	-	1,396	-
National government programs	3,340,544	2,301	-	-	(3,338,243)	-
Other appropriations	2,048,026	-	-	-	(2,048,026)	-
Payments to component units	4,954,055	-	3,000,000	-	(1,954,055)	-
Boards, commissions and other	2,553,577	486,481	923,107	-	(1,143,989)	-
Future operations	-	-	-	500,000	500,000	-
Capital projects	391,386	-	-	-	(391,386)	-
<b>Total primary government</b>	<b>\$ 48,250,245</b>	<b>\$ 5,500,375</b>	<b>\$ 18,699,430</b>	<b>\$ 694,067</b>	<b>(23,356,373)</b>	<b>-</b>
<b>Component units:</b>						
FSM Telecommunications Corporation	\$ 12,530,206	\$ 11,944,507	\$ -	\$ -	-	(585,699)
FSM Development Bank	2,206,191	1,991,153	1,000,000	-	-	784,962
National Fisheries Corporation	3,752,056	3,383,825	-	-	-	(368,231)
College of Micronesia - FSM	18,008,150	16,904,276	790,038	-	-	(313,836)
FSM Coconut Development Authority	527,133	114,666	215,534	-	-	(196,933)
<b>Total component units</b>	<b>\$ 37,023,736</b>	<b>\$ 34,338,427</b>	<b>\$ 2,005,572</b>	<b>\$ -</b>	<b>-</b>	<b>(679,737)</b>
<b>General revenues:</b>						
<b>Taxes:</b>						
Income					3,073,616	-
Import					2,840,467	-
Gross receipts					3,457,953	-
Fuel					160,692	-
Fishing rights					12,067,418	-
Unrestricted investment earnings					2,910,243	1,217,403
Other					883,928	304,605
Special item - write off of capital assets					(673,200)	-
<b>Total general revenues and special items</b>					<b>24,721,117</b>	<b>1,522,008</b>
Change in net assets					1,364,744	842,271
Net assets at the beginning of the year					65,508,518	83,004,994
Net assets at the end of the year					<b>\$ 66,873,262</b>	<b>\$ 83,847,265</b>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Balance Sheet  
Governmental Funds  
September 30, 2004**

	Special Revenue						Permanent	Other Governmental Funds	Total
	General	U.S Federal Grants	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Sector Grants	Compact Trust		
<b>ASSETS</b>									
Cash and cash equivalents	\$ 1,833,304	\$ 400	\$ -	\$ -	\$ 363,582	\$ -	\$ -	\$ 31,541	\$ 2,228,827
Time certificates of deposit	1,149,850	-	-	-	-	-	-	-	1,149,850
Equity in internal investment pool	7,800,391	-	-	-	-	-	-	3,713,137	11,513,528
Investments	1,500,000	-	7,270,802	2,827,682	2,104,086	-	-	3,832,273	17,534,843
Receivables, net:									
General	4,679,330	-	-	-	939,635	-	-	-	5,618,965
Taxes	3,136,810	-	-	-	-	-	-	-	3,136,810
Federal agencies	-	991,314	-	-	-	-	-	726,755	1,718,069
Loans	5,161,987	-	6,179,511	-	27,800,704	-	-	1,228,636	40,370,838
Other governments and agencies	915,070	229,808	-	-	-	1,008,082	-	-	2,152,960
Accrued interest	8,662	-	55,273	-	-	-	-	10,446	74,381
Other	-	-	-	-	-	-	-	6,086	6,086
Due from component units	-	-	806,412	-	-	-	-	-	806,412
Due from other funds	5,362,688	1,408,794	-	-	-	690,820	-	2,316,031	9,778,333
Advances	4,443,148	62,410	-	-	-	-	-	61,402	4,566,960
Inventories	123,928	-	-	-	-	-	-	-	123,928
Other assets	-	-	-	-	-	-	-	192,204	192,204
Restricted assets:									
Investments	-	-	-	-	-	-	8,515,000	-	8,515,000
<b>Total assets</b>	<b>\$ 36,115,168</b>	<b>\$ 2,692,726</b>	<b>\$ 14,311,998</b>	<b>\$ 2,827,682</b>	<b>\$ 31,208,007</b>	<b>\$ 1,698,902</b>	<b>\$ 8,515,000</b>	<b>\$ 12,118,511</b>	<b>\$ 109,487,994</b>
<b>LIABILITIES AND FUND BALANCES</b>									
<b>Liabilities:</b>									
Accounts payable	\$ 1,355,332	\$ 1,368,601	\$ -	\$ 1,253	\$ 1,707	\$ 1,503,235	\$ -	\$ 738,509	\$ 4,968,637
Other liabilities and accruals	2,366,361	-	-	-	2,183	-	-	1,805,360	4,173,904
Tax refunds payable	521,508	-	-	-	-	-	-	-	521,508
Due to FSM State Governments	5,174,469	1,349,890	-	-	-	-	-	961,721	7,486,080
Due to other funds	4,415,645	-	-	2,965,974	207,168	187,366	-	2,002,180	9,778,333
Deferred revenue	-	-	-	-	-	-	-	75,358	75,358
<b>Total liabilities</b>	<b>13,833,315</b>	<b>2,718,491</b>	<b>-</b>	<b>2,967,227</b>	<b>211,058</b>	<b>1,690,601</b>	<b>-</b>	<b>5,583,128</b>	<b>27,003,820</b>
<b>Fund balances (deficits):</b>									
<b>Reserved for:</b>									
Related assets	12,806,395	-	6,179,511	2,827,682	31,208,007	-	8,515,000	5,060,909	66,597,504
Encumbrances	3,744,073	2,787,487	-	-	-	284,358	-	1,304,104	8,120,022
Continuing appropriations	6,995,876	-	-	-	-	-	-	2,007,204	9,003,080
Compact programs	-	-	8,132,487	-	-	-	-	1,364,150	9,496,637
<b>Unreserved:</b>									
General fund	(1,264,491)	-	-	-	-	-	-	-	(1,264,491)
Special revenue funds	-	(2,813,252)	-	(2,967,227)	(211,058)	(276,057)	-	(172,768)	(6,440,362)
Capital projects funds	-	-	-	-	-	-	-	(3,028,216)	(3,028,216)
<b>Total fund balances (deficit)</b>	<b>22,281,853</b>	<b>(25,765)</b>	<b>14,311,998</b>	<b>(139,545)</b>	<b>30,996,949</b>	<b>8,301</b>	<b>8,515,000</b>	<b>6,535,383</b>	<b>82,484,174</b>
<b>Total liabilities and fund balances</b>	<b>\$ 36,115,168</b>	<b>\$ 2,692,726</b>	<b>\$ 14,311,998</b>	<b>\$ 2,827,682</b>	<b>\$ 31,208,007</b>	<b>\$ 1,698,902</b>	<b>\$ 8,515,000</b>	<b>\$ 12,118,511</b>	
Amounts reported for governmental activities in the statement of net assets are different because:									
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds								\$ 19,913,680	
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:									
Loans payable								(34,885,437)	
Compensated absences payable								(639,155)	
									(15,610,912)
Net assets of governmental activities									<b>\$ 66,873,262</b>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)  
Governmental Funds  
Year Ended September 30, 2004

	Special Revenue						Permanent		Total
	General	U.S Federal Grants	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Sector Grants	Compact Trust	Other Governmental Funds	
<b>Revenues:</b>									
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 9,136,337	\$ -	\$ -	\$ 9,136,337
Taxes	9,532,728	-	-	-	-	-	-	-	9,532,728
Federal and other grants	-	9,256,768	-	-	-	-	500,000	306,325	10,063,093
Fishing rights	12,067,418	-	-	-	-	-	-	-	12,067,418
Interest and dividends	2,000,000	-	194,067	-	-	-	-	305,778	2,499,845
Fees and charges	673,698	-	-	-	-	-	-	4,826,677	5,500,375
Net increase in the fair value of investments	604,465	-	-	-	-	-	-	-	604,465
Other	782,180	-	63,266	-	732	-	-	37,750	883,928
<b>Total revenues</b>	<b>25,660,489</b>	<b>9,256,768</b>	<b>257,333</b>	<b>-</b>	<b>732</b>	<b>9,136,337</b>	<b>500,000</b>	<b>5,476,530</b>	<b>50,288,189</b>
<b>Expenditures:</b>									
<b>Current:</b>									
<b>General government:</b>									
President's office	692,066	265,245	-	-	-	-	-	-	957,311
External affairs and LNOs	3,200,428	-	-	-	-	-	-	-	3,200,428
Health, education and social affairs	294,868	7,437,687	-	-	-	1,805,513	-	6,066,594	15,604,662
Economic affairs	106,440	29,205	1,592,263	-	116,905	752,870	-	910,697	3,508,380
Transportation, communication and infrastructure	645,590	-	-	-	-	-	-	11,859	657,449
Finance and administration	998,836	237,752	-	-	308,514	1,208,580	-	-	2,753,682
Justice	1,275,547	-	-	-	-	1,269,818	-	16,042	2,561,407
Office of the Public Defender	574,522	-	-	-	-	-	-	-	574,522
Judiciary	334,671	-	-	-	-	641,500	-	-	976,171
Legislature	2,593,723	-	-	-	-	-	-	-	2,593,723
Office of the Public Auditor	31,591	437,860	-	-	-	404,439	-	-	873,890
National government program:	3,386,211	-	-	-	-	-	-	-	3,386,211
Other appropriations	2,107,867	-	-	-	-	-	-	-	2,107,867
Payments to component units	729,055	-	250,000	-	-	3,000,000	-	975,000	4,954,055
Boards, commissions and othe	1,607,771	877,791	-	-	-	45,316	-	-	2,530,878
Capital projects	-	-	-	-	-	-	-	484,836	484,836
<b>Total expenditures</b>	<b>18,579,186</b>	<b>9,285,540</b>	<b>1,842,263</b>	<b>-</b>	<b>425,419</b>	<b>9,128,036</b>	<b>-</b>	<b>8,465,028</b>	<b>47,725,472</b>
Excess (deficiency) of revenues over (under) expenditures	7,081,303	(28,772)	(1,584,930)	-	(424,687)	8,301	500,000	(2,988,498)	2,562,717
<b>Other financing sources (uses):</b>									
Loan proceeds	-	-	-	-	1,086,729	-	-	-	1,086,729
Operating transfers in	426,208	-	-	-	-	-	8,015,000	514,083	8,955,291
Operating transfers out	(4,224,902)	-	-	-	-	-	-	(4,730,389)	(8,955,291)
<b>Total other financing sources (uses), net</b>	<b>(3,798,694)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,086,729</b>	<b>-</b>	<b>8,015,000</b>	<b>(4,216,306)</b>	<b>1,086,729</b>
<b>Net change in fund balances (deficits)</b>	<b>3,282,609</b>	<b>(28,772)</b>	<b>(1,584,930)</b>	<b>-</b>	<b>662,042</b>	<b>8,301</b>	<b>8,515,000</b>	<b>(7,204,804)</b>	<b>3,649,446</b>
<b>Fund balances (deficits) at the beginning of the year</b>	<b>18,999,244</b>	<b>3,007</b>	<b>15,896,928</b>	<b>(139,545)</b>	<b>30,334,907</b>	<b>-</b>	<b>-</b>	<b>13,740,187</b>	<b>78,834,728</b>
<b>Fund balances (deficit) at the end of the year</b>	<b>\$ 22,281,853</b>	<b>\$ (25,765)</b>	<b>\$ 14,311,998</b>	<b>\$ (139,545)</b>	<b>\$ 30,996,949</b>	<b>\$ 8,301</b>	<b>\$ 8,515,000</b>	<b>\$ 6,535,383</b>	<b>\$ 82,484,174</b>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund  
Balances of Governmental Funds to the Statement of Activities  
Year Ended September 30, 2004

Amounts reported for governmental activities in the statement of activities on page 12 are different because:

Net change in fund balances - total governmental funds from page 14	\$ 3,649,446
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period, including increases to construction in progress	(664,490)
The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets. This amount is the net effect of these differences in the treatment of long - term debt and related items	(974,593)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in governmental funds. These expenses include the write-off of capital assets, accrued annual leave and claims and judgment payable that are reported in the statement of activities, but not in funds	<u>(645,619)</u>
Change in net assets of governmental activities as presented on page 12.	\$ <u>1,364,744</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combining Statement of Fiduciary Net Assets  
Fiduciary Funds - Private Purpose Trusts  
September 30, 2004

	<u>FSM Social Security Administration</u>	<u>Pohnpei State Development Loan Fund</u>	<u>Yap State Development Loan Fund</u>	<u>Total</u>
<b><u>ASSETS</u></b>				
Cash and cash equivalents	\$ 881,686	\$ 140,441	\$ 42,005	\$ 1,064,132
Time certificates of deposit	-	493,110	126,458	619,568
Receivables, net:		-	-	
Contributions	1,979,938	-	-	1,979,938
Loans	-	149,354	152,580	301,934
Accrued interest	167,605	4,414	708	172,727
Other	8,646	-	-	8,646
Investments	36,763,144	-	-	36,763,144
Capital assets, net of accumulated depreciation	<u>91,221</u>	<u>-</u>	<u>-</u>	<u>91,221</u>
Total assets	<u>39,892,240</u>	<u>787,319</u>	<u>321,751</u>	<u>41,001,310</u>
<b><u>LIABILITIES</u></b>				
Accounts payable	76,807	-	-	76,807
Other liabilities and accruals	33,596	-	2,074	35,670
Due to component units	<u>-</u>	<u>67,404</u>	<u>112,641</u>	<u>180,045</u>
Total liabilities	<u>110,403</u>	<u>67,404</u>	<u>114,715</u>	<u>292,522</u>
<b><u>NET ASSETS</u></b>				
Held in trust for:				
Social security benefits	39,781,837	-	-	39,781,837
Other purposes	<u>-</u>	<u>719,915</u>	<u>207,036</u>	<u>926,951</u>
Total net assets	<u>\$ 39,781,837</u>	<u>\$ 719,915</u>	<u>\$ 207,036</u>	<u>\$ 40,708,788</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combining Statement of Changes in Fiduciary Net Assets  
Fiduciary Funds - Private Purpose Trusts  
Year Ended September 30, 2004

	FSM Social Security Administration	Pohnpei State Development Loan Fund	Yap State Development Loan Fund	Total
Additions:				
Contributions:				
Private employees	\$ 5,896,019	\$ -	\$ -	\$ 5,896,019
Government employees	5,931,863	-	-	5,931,863
Penalties and interest	193,137	-	-	193,137
Other	254,882	-	-	254,882
Total contributions	<u>12,275,901</u>	<u>-</u>	<u>-</u>	<u>12,275,901</u>
Investment earnings:				
Net increase in the fair value of investments	2,591,424	-	-	2,591,424
Interest and dividends	52,002	-	-	52,002
Total investment earnings	2,643,426	-	-	2,643,426
Less investment expense	239,484	-	-	239,484
Net investment earnings	<u>2,403,942</u>	<u>-</u>	<u>-</u>	<u>2,403,942</u>
Other	-	16,815	10,064	26,879
Total additions	<u>14,679,843</u>	<u>16,815</u>	<u>10,064</u>	<u>14,706,722</u>
Deductions:				
Benefits	11,309,808	-	-	11,309,808
Refunds	11,430	-	-	11,430
Administrative expenses	923,670	16,815	5,032	945,517
Total deductions	<u>12,244,908</u>	<u>16,815</u>	<u>5,032</u>	<u>12,266,755</u>
Change in net assets	2,434,935	-	5,032	2,439,967
Net assets at the beginning of the year	<u>37,346,902</u>	<u>719,915</u>	<u>202,004</u>	<u>38,268,821</u>
Net assets at the end of the year	<u>\$ 39,781,837</u>	<u>\$ 719,915</u>	<u>\$ 207,036</u>	<u>\$ 40,708,788</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Combining Statement of Net Assets  
Component Units  
September 30, 2004**

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	Total
<b>ASSETS</b>						
<b>Current assets:</b>						
Cash and cash equivalents	\$ 3,387,526	\$ 7,541,541	\$ 220,598	\$ 5,408,035	\$ 29,780	\$ 16,587,480
Time certificates of deposit	105,231	-	-	-	-	105,231
Investments	8,782,450	-	-	-	-	8,782,450
Receivables, net:						
General	963,909	15,392	490,727	2,729,381	2,358	4,201,767
Loans	-	1,628,513	-	-	-	1,628,513
Interest	-	142,008	-	-	-	142,008
Other	387,908	-	754,370	3,163,780	-	4,306,058
Due from primary government	-	180,045	-	-	-	180,045
Advances	34,515	-	135,883	-	-	170,398
Inventories	416,669	-	97,944	98,001	87,901	700,515
Prepaid expenses	990,830	1,000	-	16,250	1,362	1,009,442
<b>Total current assets</b>	<b>15,069,038</b>	<b>9,508,499</b>	<b>1,699,522</b>	<b>11,415,447</b>	<b>121,401</b>	<b>37,813,907</b>
<b>Noncurrent assets:</b>						
Capital assets, net of accumulated depreciation	42,699,142	107,588	620,961	13,157,013	238,794	56,823,498
Investments	910,114	8,362,109	486,855	1,948,822	-	11,707,900
Loans receivable	-	14,649,821	-	-	-	14,649,821
Grants and contacts receivable	65,848	-	-	221,157	-	287,005
<b>Total noncurrent assets</b>	<b>43,675,104</b>	<b>23,119,518</b>	<b>1,107,816</b>	<b>15,326,992</b>	<b>238,794</b>	<b>83,468,224</b>
<b>Total assets</b>	<b>\$ 58,744,142</b>	<b>\$ 32,628,017</b>	<b>\$ 2,807,338</b>	<b>\$ 26,742,439</b>	<b>\$ 360,195</b>	<b>\$ 121,282,131</b>
<b>LIABILITIES</b>						
<b>Current liabilities:</b>						
Current portion of long-term debt	\$ 710,137	\$ -	\$ 3,600,000	\$ -	\$ -	\$ 4,310,137
Accounts payable	122,913	70,318	1,935,153	457,111	21,603	2,607,098
Other liabilities and accruals	609,273	61,869	-	1,386,044	4,538	2,061,724
Due to primary government	-	806,412	-	-	-	806,412
Deferred revenue	2,391	-	-	2,393,583	-	2,395,974
<b>Total current liabilities</b>	<b>1,444,714</b>	<b>938,599</b>	<b>5,535,153</b>	<b>4,236,738</b>	<b>26,141</b>	<b>12,181,345</b>
<b>Noncurrent liabilities:</b>						
Noncurrent portion of long-term debt	25,253,521	-	-	-	-	25,253,521
<b>Total noncurrent liabilities</b>	<b>25,253,521</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>25,253,521</b>
<b>Total liabilities</b>	<b>26,698,235</b>	<b>938,599</b>	<b>5,535,153</b>	<b>4,236,738</b>	<b>26,141</b>	<b>37,434,866</b>
<b>NET ASSETS</b>						
Invested in capital assets, net of related debt	16,735,484	107,588	620,961	13,157,013	238,794	30,859,840
Restricted for:						
Nonexpendable	-	-	-	1,987,331	-	1,987,331
Unrestricted	15,310,423	31,581,830	(3,348,776)	7,361,357	95,260	51,000,094
<b>Total net assets</b>	<b>32,045,907</b>	<b>31,689,418</b>	<b>(2,727,815)</b>	<b>22,505,701</b>	<b>334,054</b>	<b>83,847,265</b>
<b>Total liabilities and net assets</b>	<b>\$ 58,744,142</b>	<b>\$ 32,628,017</b>	<b>\$ 2,807,338</b>	<b>\$ 26,742,439</b>	<b>\$ 360,195</b>	<b>\$ 121,282,131</b>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Combining Statement of Revenues, Expenses, and Changes in Net Assets  
Component Units  
Year Ended September 30, 2004**

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	Total
Operating revenues:						
Charges for services	\$ 11,796,959	\$ 1,965,704	\$ 3,383,825	\$ 1,114,862	\$ 114,666	\$ 18,376,016
Other	147,548	25,449	-	15,789,414	-	15,962,411
Total operating revenues	<u>11,944,507</u>	<u>1,991,153</u>	<u>3,383,825</u>	<u>16,904,276</u>	<u>114,666</u>	<u>34,338,427</u>
Operating expenses:						
Cost of services	349,447	1,317,420	2,934,052	-	259,329	4,860,248
Depreciation	2,999,448	28,771	211,974	1,101,776	46,221	4,388,190
Administrative costs	8,010,490	860,000	606,030	16,906,374	221,583	26,604,477
Total operating expenses	<u>11,359,385</u>	<u>2,206,191</u>	<u>3,752,056</u>	<u>18,008,150</u>	<u>527,133</u>	<u>35,852,915</u>
Operating income (loss)	<u>585,122</u>	<u>(215,038)</u>	<u>(368,231)</u>	<u>(1,103,874)</u>	<u>(412,467)</u>	<u>(1,514,488)</u>
Nonoperating revenues (expenses):						
Net increase in the fair value of investments	923,632	-	-	272,418	-	1,196,050
Interest income	21,353	-	-	-	-	21,353
Interest expense	(1,170,821)	-	-	-	-	(1,170,821)
Contributions from primary government	-	1,000,000	-	790,038	215,534	2,005,572
Other income	5,852	36,186	236,752	-	25,815	304,605
Total nonoperating revenues (expenses), net	<u>(219,984)</u>	<u>1,036,186</u>	<u>236,752</u>	<u>1,062,456</u>	<u>241,349</u>	<u>2,356,759</u>
Capital contributions	-	-	-	-	-	-
Net income (loss)	365,138	821,148	(131,479)	(41,418)	(171,118)	842,271
Net assets at the beginning of the year	<u>31,680,769</u>	<u>30,868,270</u>	<u>(2,596,336)</u>	<u>22,547,119</u>	<u>505,172</u>	<u>83,004,994</u>
Net assets at the end of the year	<u>\$ 32,045,907</u>	<u>\$ 31,689,418</u>	<u>\$ (2,727,815)</u>	<u>\$ 22,505,701</u>	<u>\$ 334,054</u>	<u>\$ 83,847,265</u>

See accompanying notes to basic financial statements.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

**(1) Summary of Significant Accounting Policies**

The accompanying financial statements of the Federated States of Micronesia (FSM) National Government have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the FSM National Government's accounting policies are described below.

**A. Reporting Entity**

The FSM is an independent sovereign nation made up of the four states of Chuuk, Kosrae, Pohnpei, and Yap (the States). The FSM National Government is a constitutional government comprised of three branches: the Legislative Branch (the Congress), consisting of 14 members (one from each State who are elected for a term of four years, and ten who are elected for a term of two years, whose seats are apportioned by population); the Executive Branch, headed by the President and Vice President who are primarily responsible for executing the laws and administering national government services; and the Judiciary Branch made up of the FSM Supreme Court, which consists of a Chief Justice and up to five Associate Justices. The Congress elects two of its four-year members at its first session following an election to serve as President and Vice President.

For financial reporting purposes, the FSM National Government has included all funds, organizations, agencies, boards, commissions and institutions. The FSM National Government has also considered all potential component units for which it is financially accountable as well as other entities for which the nature and significance of their relationship with the FSM National Government are such that exclusion would cause the FSM National Government's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the FSM National Government, as the primary government, has appointed a voting majority of an organization's governing body and either has the ability to impose its will on that organization or there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the FSM National Government. Financial accountability also exists if an organization is determined to be fiscally dependent on the primary government, although the primary government does not appoint a voting majority of the organization's governing board.

Each blended and discretely presented component unit of the FSM National Government has a September 30 year-end except for the FSM Development Bank and the FSM Social Security Administration, which each have a December 31 year-end.

Once financial accountability has been determined for a potential component unit, that component unit is either blended into the primary government or discretely presented from the primary government. Potential component units that do not meet the financial accountability criteria, but where a voting majority of the governing board is appointed by the FSM National Government, are deemed to be related organizations. The nature and relationship of the FSM National Government's component units and related organizations are disclosed in the following section.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Blended component units are entities that are legally separate from the FSM National Government, but are so related to the FSM National Government that they are, in substance, the same as the FSM National Government or entities providing services entirely or almost entirely to the FSM National Government. The net assets and results of operations of the following legally separate entities are presented as part of the FSM National Government's operations:

Blended Component Units

The following component units are blended within the primary government:

Employees' Health Insurance Fund (the Fund), a Governmental Fund Type - Special Revenue Fund. The Fund was established under FSM Public Law No. 3-82, as amended by FSM Public Law No. 12-77, to facilitate the payment of health costs incurred by eligible members. The Fund is governed by a seven-member Board of Directors appointed by the President with the advice and consent of the Congress.

FSM Social Security Administration (FSMSSA), a Fiduciary Fund Type - Private Purpose Trust Fund. FSMSSA was established under FSM Public Law No. 2-74 to provide retirement, disability and survivor benefits for the citizens of the FSM. FSMSSA is governed by a five-member Board of Directors nominated by the President and confirmed by the Congress.

Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government are such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete. The component units' column of the basic financial statements includes the financial data of the following major component units:

FSM Telecommunications Corporation (FSMTC): FSMTC was incorporated under FSM Public Law No. 2-10 to engage in the business of providing telecommunications services, except radio and television broadcasting, throughout the FSM and to points outside the FSM. FSMTC is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governors of each State (with the advice and consent of the respective State legislatures).

FSM Development Bank (FSMDB): FSMDB was established under FSM Public Law No. 8-47 to advance the economic development of the FSM through the provision of economic development loans. FSMDB is governed by a seven-member Board of Directors appointed by election at the annual shareholders meeting by the plurality of votes thereof. As of December 31, 2003, FSMDB has issued 2,997,883 shares to the FSM National Government (98.7%), the State of Chuuk (1%), and the State of Kosrae (0.3%).

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

**(1) Summary of Significant Accounting Policies, Continued**

**A. Reporting Entity, Continued**

**Discretely Presented Component Units, Continued**

National Fisheries Corporation (NFC): NFC was established under FSM Public Law No. 3-14 to promote the development of pelagic fisheries and related industries within the extended fishery zone for the benefit of the people of the FSM. NFC is governed by a seven-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress), four appointees by the Governors of each State (with the advice and consent of the respective State legislatures), the Executive Director of the Micronesian Maritime Authority, and the Secretary of the Department of Economic Affairs.

College of Micronesia-FSM (COM-FSM): COM-FSM was established under FSM Public Law No. 7-79 to serve the varied post-secondary and adult educational needs of the FSM. COM-FSM is governed by a five-member Board of Regents appointed by the President with the advice and consent of the Congress.

FSM Coconut Development Authority (CDA): CDA was established under FSM Public Law No. 1-156 to engage in the manufacture and processing of all products derived from the coconut tree; to buy, collect, market, sell, export, inspect, improve the quality, and deal with, in general, all products derived from the coconut tree; to establish prices to producers or sellers of coconut products in the FSM; to collect and receive all monies derived from the sales of coconut products; and to stabilize the price of these products. CDA is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governors of each State (with the advice and consent of the respective State legislatures).

The FSM National Government's component units, departments, and funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities or obtaining them directly from the Office of the Public Auditor:

P.O. Box PS05  
Palikir, Pohnpei State, FM, 96941

**B. Government-Wide Financial Statements**

The Statement of Net Assets and the Statement of Activities report financial information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been eliminated from these statements except for other charges between the primary government and the discretely presented component units. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Assets presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$23,366,526 of restricted net assets, of which \$434,493 is restricted by enabling legislation.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Separate financial statements are provided for governmental funds and fiduciary funds even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements, Continued

The FSM National Government reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements account for the general governmental activities of the FSM National Government and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the FSM National Government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The FSM National Government reports the following fund types:

1. Governmental Fund Types

i. General Fund

This fund is the primary operating fund of the FSM National Government. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major FSM National Government capital facilities financed primarily from loans and federal reimbursements.

iv. Permanent Funds

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

2. Fiduciary Fund Types

i. Private Purpose Trust Funds

These funds are used to account for resources held in trust under which principal and income benefit certain individuals.

These include funds held in trust by the FSM Social Security Administration (FSMSSA) for the beneficiaries of the FSMSSA Retirement Fund, and funds held in trust by the FSM Development Bank for the State of Pohnpei and the State of Yap.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The FSM National Government reports the following major funds:

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions formally related to the Trust Territory of the Pacific Islands (TTPI) United States federally assisted funds, which are subgranted to the FSM National Government, as well as other direct federal grants that the FSM National Government received from the United States government once the FSM National Government's subgrantee status with the TTPI ceased.

Section 111 Investment Development Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, Compact of Free Association, Section 111, and approved by the FSM Congress. These funds are administered by the FSM Development Bank.

Early Retirement Program Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for the Early Retirement Program activities.

Asian Development Bank Loan Fund, a Governmental Fund Type - Special Revenue Fund. This fund was established by FSM Public Law No. 7-101 mainly to carry out the purpose of the Fisheries Development Project Loan Agreement of 1992 between the Government of the Federated States of Micronesia and the Asian Development Bank (ADB), and the Technical Assistance Agreement of 1992 for Institutional Strengthening for Marine Resource Management and Conservation between the FSM and ADB.

Compact Sector Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for funds received under sector grants pursuant to Section 211(a) of the Compact of Free Association, as amended.

Compact Trust Fund, a Governmental Fund Type - Permanent Fund, accounts for the State's contributions to the Trust Fund established in accordance with Section 215 of the Compact of Free Association, as amended, to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the FSM National Government's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

F. Cash and Cash Equivalents and Time Certificates of Deposit

The FSM National Government pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the FSM National Government. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.

As of September 30, 2004, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit were \$3,378,677 and the corresponding bank balances were \$4,625,235. Of the bank balance amounts, \$3,146,577 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2004, bank deposits in the amount of \$452,742 were FDIC insured. The FSM National Government does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

As of September 30, 2004, the carrying amount of the fiduciary funds' total cash and cash equivalents and time certificates of deposit were \$1,683,700 and the corresponding bank balances were \$1,972,753. Of the bank balance amounts, \$1,479,643 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2004, bank deposits in the amount of \$342,005 were FDIC insured. The fiduciary funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

As of September 30, 2004, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit were \$16,692,711 and the corresponding bank balances were \$20,781,199. Of the bank balance amounts, \$13,983,936 is maintained in financial institutions subject to FDIC insurance. As of September 30, 2004, bank deposits in the amount of \$1,029,780 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

G. Investments

Investments are carried at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

G. Investments, Continued

An investment of 20% or more of the voting stock of an investee is presumed to give the investor significant influence. Under the equity method, the investor records, as earnings or loss, its proportionate share of the investee's earnings or loss.

H. Receivables

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the FSM National Government for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies".

I. Inventories and Prepaid Items

Inventories of materials and supplies are determined by physical count and are valued at the lower of cost (principally average cost) or market.

Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

J. Interfund Receivables/Payables

During the course of its operations, the FSM National Government records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

These balances result from time lag between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the FSM National Government has investments recorded in the Compact Trust Fund of \$8,515,000, which is restricted in that they are not available to be used in current operations.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

L. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the applicable governmental or business-type activities columns of the government-wide financial statements. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed \$250 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$800 are capitalized. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

Property, plant and equipment of the primary government and the component units are depreciated using the straight-line method over their estimated useful lives, with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

Buildings	50 years
Improvements	20 years
Facilities	3 - 40 years
Machinery and equipment	3 - 20 years
Furniture and fixtures	3 - 10 years
Ships	25 years
Motor vehicles	3 years
Over-the-road vehicles	3 years

M. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

N. Deferred Revenue

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to their being earned. In the governmental fund financial statements deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the "available" criterion for revenue recognition under the modified accrual basis of accounting. The deferred revenue in the governmental fund types has primarily resulted as federal funds received in advance of eligible expenditures.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

**(1) Summary of Significant Accounting Policies, Continued**

**O. Compensated Absences**

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide and fiduciary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of 4 hours bi-weekly, if less than 3 years of service, 6 hours bi-weekly, if between 3 and 10 years of service, and 8 hours bi-weekly if over 10 years of service, limited to 45 working days.

**P. Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

**Q. Fund Equity**

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2004, is represented by the following assets:

	U.S. Federal	Section 111 Investment	Early Retirement	Asian Developmen	Compact Sector	Compact Trust	Other Government	Total
<u>General</u>	<u>Grants</u>	<u>Developmen</u>	<u>Program</u>	<u>Bank Loan</u>	<u>Grants</u>	<u>Trust</u>	<u>Funds</u>	
Cash and cash equivalents	\$ 760,972	\$ -	\$ -	\$ 363,582	\$ -	\$ -	\$ -	\$ 1,124,554
Time certificate of deposit	1,149,850	-	-	-	-	-	-	1,149,850
Investments	1,500,000	-	2,827,682	2,104,086	-	-	3,832,273	10,264,041
Receivables:								
General	1,176,791	-	-	939,635	-	-	-	2,116,426
Loans	5,161,987	6,179,511	-	27,800,704	-	-	1,228,636	40,370,838
Other governments	915,070	-	-	-	-	-	-	915,070
Due from other funds	2,141,725	-	-	-	-	-	-	2,141,725
Restricted assets:								
Investments	-	-	-	-	-	8,515,000	-	8,515,000
	<u>\$12,806,395</u>	<u>\$ -</u>	<u>\$ 6,179,511</u>	<u>\$ 2,827,682</u>	<u>\$ 31,208,007</u>	<u>\$ -</u>	<u>\$ 8,515,000</u>	<u>\$ 5,060,909</u>
							<u>\$ 5,060,909</u>	<u>\$ 66,597,504</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

R. Risk Financing

The FSM National Government is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the FSM National Government management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the FSM National Government reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

S. New Accounting Standards

During fiscal year 2004, the FSM National Government implemented GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of GASB Statement 14) and GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*. GASB Statement No. 39 provides additional guidance on GASB Statement No.14, in determining whether an entity should be reported as a component unit based on the nature and significance of its relationship with a primary government. GASB Technical Bulletin No. 2003-1 applies to derivatives that are not reported at fair value on the statement of net assets and clarifies guidance on derivative disclosures, pending the results of GASB's project on reporting and measurement of derivatives and hedging activities. Implementation of these pronouncements did not have an effect on the financial statements of the FSM National Government.

For fiscal year 2005, the FSM National Government will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3) and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 42 establishes standards for impairment of capital assets when service utility has declined significantly and unexpectedly. Management does not believe that the implementation of these statements will have a material effect on the financial statements of the FSM National Government.

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the FSM National Government.

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

In July 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the FSM National Government.

(2) Investments

GASB Statement No. 3 requires government entities to categorize investments to give an indication of the level of credit risk assumed by the entity at year end. The three categories are described below:

- Category 1      Insured or registered, or securities held by the FSM National Government or its agent in the FSM National Government's name;
- Category 2      Uninsured and unregistered, with securities held by the broker's or dealer's trust department or agent in the FSM National Government's name; or
- Category 3      Uninsured and unregistered, with securities held by the broker or dealer, or by its trust department or agent but not in the FSM National Government's name.

FSM Public Law No. 4-77, which approved the "Internal Budget and Finance Procedures Under the Compact of Free Association", established and designated the Federated Development Authority (FDA) as the agency under which Compact funds available for investment are obligated and placed. This law also provides that all FDA investment funds shall be managed by the FSM National Government's Secretary of Finance.

The FDA has selected investment managers who are given authority to buy and sell securities as follows:

1. Investment managers may invest in stocks, bonds and cash equivalents. Minimum standards of quality for investments at the time of purchase are:
  - a. Stocks - A "B" rating by a national rating service. Non-rated or international stocks such as banks or insurance companies must be equal in quality or higher.
  - b. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or Agency Securities which are not rated.
  - c. Cash equivalents - The manager may engage in all normally accepted short-term investment practices including, but not limited to: U.S. Treasury and Agency securities, bankers' acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply:

**FEDERATED STATES OF MICRONESIA  
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**(2) Investments, Continued**

- i. Commercial paper must be rated A-1/P-1 or higher by Standard & Poor Corporation and Moody's Investor Services.
  - ii. Certificates of deposit must be from FDIC insured banks which must have assets in excess of two billion dollars. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance unless collateralized by U.S. Treasury Securities at 102%.
2. The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poor 500 Index, unless prior approval is received from the FSM National Government's Secretary of Finance.
  3. No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval of the FSM National Government's Secretary of Finance.

Investments of the primary government and the discretely presented component units as September 30, 2004, are as follows:

Major Governmental Funds

	<u>Categories</u>			<u>Carrying Value</u>
	<u>1</u>	<u>2</u>	<u>3</u>	
General Fund:				
Common stock	\$ <u>1,500,000</u>	\$ <u>-</u>	\$ <u>-</u>	\$ 1,500,000
Pooled investments				<u>7,800,391</u>
				<u>\$ 9,300,391</u>
Section 111 Investment Development Fund:				
Pooled investments				<u>\$ 7,270,802</u>
Early Retirement Program Fund:				
Pooled investments				<u>\$ 2,827,682</u>
Asian Development Bank Loan Fund:				
Pooled investments				<u>\$ 2,104,086</u>
Compact Trust Fund:				
Cash management funds				<u>\$ 8,515,000</u>

The FSM National Government owns 50,000 shares of the common stock of a commercial enterprise located in the Commonwealth of the Northern Marianas. The investment of \$1,500,000 is accounted for at cost since the investment constitutes a .05% ownership share.

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

**(2) Investments, Continued**

Fiduciary Funds

	Categories			Carrying Value
	1	2	3	
FSM Social Security Administration:				
Common stock	\$ -	\$ 21,755,629	\$ -	\$ 21,755,629
U.S. Government agencies	-	6,137,557	-	6,137,557
U.S. Government notes and bonds	-	5,831,677	-	5,831,677
Corporate notes and bonds	-	<u>2,130,182</u>	-	<u>2,130,182</u>
	<u>\$ -</u>	<u>\$ 35,855,045</u>	<u>\$ -</u>	35,855,045
Money market funds				<u>908,099</u>
				<u>\$ 36,763,144</u>

Nonmajor Governmental Funds

Common stock	\$ <u>3,832,274</u>	\$ -	\$ -	\$ 3,832,274
Pooled investments				<u>3,713,137</u>
				<u>\$ 7,545,411</u>

The FSM National Government owns 298,745 shares of the common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. The investment is accounted for on the equity method since the investment constitutes a 32% ownership share.

A summary of audited financial information as of and for the twelve months ended December 31, 2004, for investees accounted for using the equity method of accounting for investments, is as follows:

Assets	\$ <u>79,218,823</u>
Liabilities	\$ <u>66,970,567</u>
Net earnings	\$ <u>617,581</u>

Discretely Presented Component Units

	Categories			Carrying Value
	1	2	3	
FSM Telecommunications Corporation (FSMTC):				
Common stock	\$ 910,114	\$ 5,677,719	\$ -	\$ 6,587,833
U.S. Government notes and bonds	-	1,004,864	-	1,004,864
Corporate notes and bonds	-	<u>2,099,867</u>	-	<u>2,099,867</u>
	<u>\$ 910,114</u>	<u>\$ 8,782,450</u>	<u>\$ -</u>	<u>\$ 9,692,564</u>
FSM Development Bank (FSMDB):				
Common stock	\$ 662,188	\$ -	\$ -	\$ 662,188
U.S. Government agencies	-	<u>7,699,921</u>	-	<u>7,699,921</u>
	<u>\$ 662,188</u>	<u>\$ 7,699,921</u>	<u>\$ -</u>	<u>\$ 8,362,109</u>

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

**(2) Investments, Continued**

**Discretely Presented Component Units, Continued**

	Categories			Carrying Value
	1	2	3	
National Fisheries Corporation (NFC):				
Common stock	\$ <u>486,855</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>486,855</u>
College of Micronesia - FSM:				
Common stock	\$ -	\$ 1,326,000	\$ -	\$ 1,326,000
Corporate notes and bonds	<u>-</u>	<u>424,096</u>	<u>-</u>	<u>424,096</u>
	\$ <u>-</u>	\$ <u>1,750,096</u>	\$ <u>-</u>	1,750,096
Money market funds				<u>198,726</u>
				<u>\$ 1,948,822</u>

FSMTC owns shares in the International Telecommunications Satellite (IntelSat). The investment of \$910,114 is accounted for at cost since the investment constitutes a .05% ownership share.

FSMDB owns 100,000 shares of the common stock of the Bank of the Federated States of Micronesia. The investment of \$662,188 is accounted for at cost since the investment constitutes an 11% ownership share.

NFC owns 50,493 shares of the common stock of the Micronesia Longline Fishing Company, Inc., an unconsolidated entity, representing a 97% ownership share. Additionally, NFC owns 50% of the shares of the common stock of the following unconsolidated entities: Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. These investments have been written down to a nil value except for NFC's investment in Chuuk Fresh Tuna, Inc.

**(3) Receivables**

Receivables as of September 30, 2004, for the primary government's individual major governmental funds, and nonmajor governmental and fiduciary funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	General	U.S. Federal Grants	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Sector Grant	Compact Trust	Nonmajor And Other Funds	Totals
Receivables:									
General	\$ 4,879,330	\$ -	\$ -	\$ -	\$ 939,635	\$ -	\$ -	\$ -	\$ 5,818,965
Taxes	3,136,810	-	-	-	-	-	-	-	3,136,810
Federal agencies	-	991,314	-	-	-	-	-	726,755	1,718,069
Contributions	-	-	-	-	-	-	-	1,979,938	1,979,938
Loans	5,161,987	-	6,179,511	-	27,800,704	-	-	3,137,523	42,279,725
Other governments and agencies	915,070	229,808	-	-	-	1,008,082	-	-	2,152,960
Accrued interest	8,662	-	55,273	-	-	-	-	183,173	247,108
Other	-	-	-	-	-	-	-	23,467	23,467
	<u>14,101,859</u>	<u>1,221,122</u>	<u>6,234,784</u>	<u>-</u>	<u>28,740,339</u>	<u>1,008,082</u>	<u>-</u>	<u>6,050,856</u>	<u>57,357,042</u>
Less: allowance for uncollectibles	<u>(200,000)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,615,688)</u>	<u>(1,815,688)</u>
Net receivables	<u>\$ 13,901,859</u>	<u>\$ 1,221,122</u>	<u>\$ 6,234,784</u>	<u>\$ -</u>	<u>\$ 28,740,339</u>	<u>\$ 1,008,082</u>	<u>\$ -</u>	<u>\$ 4,435,168</u>	<u>\$ 55,541,354</u>



**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

**(3) Receivables, Continued**

Loans receivable of the primary government are as follows:

**Major Governmental Funds**

**General Fund:**

Notes receivable due from the National Fisheries Corporation (NFC), payable in various annual installments of \$1,962 to \$86,639, non-interest bearing, and due on various dates ranging from July 2007 through April 2014. \$ 3,600,000

Loan receivable due from the State of Chuuk, payable in quarterly installments of \$416,667, non-interest bearing with a service charge of 1% per annum, due on September 30, 2001. 1,561,987

\$ 5,161,987

**Section 111 Investment Development Fund:**

Loans receivable due from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. \$ 6,179,511

**Asian Development Bank Loan Fund:**

Loan receivable due from Micronesia Longline Fishing Company, a majority-owned subsidiary of NFC, in the amount of SDR 3,514,000, interest at 6.64% per annum, repayments commencing January 15, 1998, with a maturity date of July 15, 2007. The loan is a subsidiary loan of a loan agreement (Loan Number 1257 FSM (SF)) between the FSM National Government and the Asian Development Bank (ADB). \$ 4,949,366

Loans receivable due from the Chuuk Public Utility Corporation (CPUC), the Pohnpei Utilities Corporation (PUC), and the Yap State Public Service Corporation (YSPSC). These loans are subsidiary loans of a loan agreement (Loan Number 1459 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States of Chuuk, Pohnpei and Yap whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. The States in turn on lent the loan proceeds to CPUC, PUC, and YSPSC, respectively. As of September 30, 2004, the amounts outstanding from these corporations are as follows:

Chuuk Public Utility Corporation	\$ 3,461,734	
Pohnpei Utilities Corporation	2,118,767	
Yap State Public Service Corporation	<u>2,270,837</u>	
		7,851,338

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

(3) Receivables, Continued

Major Governmental Funds, Continued

Asian Development Bank Loan Fund, Continued:

Loans receivable due from the States to assist in the implementation of an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the States were retired early with a payout of the equivalent of two-year wages. These loans are subsidiary loans of a loan agreement (Loan Number 1520 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. As of September 30, 2004, the amounts outstanding from the States are as follows:

State of Chuuk	\$ 5,300,000	
State of Kosrae	2,000,000	
State of Pohnpei	4,200,000	
State of Yap	<u>3,500,000</u>	
		<u>15,000,000</u>
		\$ <u>27,800,704</u>

Nonmajor Governmental and Fiduciary Funds

Student Loan Fund:

Loans receivable due from students under a student financial assistance loan program, interest at 4% per annum, with repayment commencing ten years and nine months after completion of study. \$ 1,606,953

Compact Capital Projects Fund:

Loan receivable due from the Caroline Fisheries Corporation, a joint venture between NFC, the Pohnpei State Economic Development Authority and the Australian-owned Tuna Development Company, Pty. Ltd., interest at 8% per annum, is uncollateralized, and is due in monthly installments of \$67,841. These loans have been fully provided for in the allowance for uncollectible accounts. 1,228,636

Pohnpei Development Loan Fund:

Loans receivable due from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 149,354

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

(3) Receivables, Continued

Nonmajor Governmental and Fiduciary Funds, Continued

Yap Development Loan Fund:

Loans receivable due from businesses and individuals at varying terms and conditions administered by the FSM Development Bank.	<u>152,580</u>
	<u>\$ 3,137,523</u>

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2004, are summarized as follows:

Receivable Fund	Payable Fund	Amount
General	Early Retirement Program	\$ 2,965,974
General	Asian Development Bank Loan	207,168
General	Compact Sector Grants	187,366
General	Nonmajor governmental funds	2,002,180
U.S. Federal Grants	General	1,408,794
Compact Sector Grants	General	690,820
Nonmajor governmental funds	General	<u>2,316,031</u>
		<u>\$ 9,778,333</u>

Interfund receivables not expected to be repaid within the next twelve months are summarized as follows:

Receivable Fund	Payable Fund	Amount
General	Nonmajor governmental funds	\$ <u>2,002,180</u>

Receivables between funds reflected as due from component units in the statement of net assets at September 30, 2004, are summarized as follows:

	Due From	Due To
Section 111 Investment Development Fund:		
FSM Development Bank	\$ <u>806,412</u>	\$ <u>-</u>

Receivables between funds reflected as due to primary government in the statement of net assets at September 30, 2004, are summarized as follows:

	Due From	Due To
FSM Development Bank:		
Section 111 Investment Development Fund	\$ <u>-</u>	\$ <u>806,412</u>

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

**(5) Capital Assets**

Capital asset activities of the primary government for the year ended September 30, 2004, are as follows:

	Balance October <u>1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2004</u>
Governmental Activities:				
Buildings and improvements	\$ 13,958,076	\$ 85,000	\$ -	\$ 14,043,076
Boats	13,967,241	15,740	(2,376,000)	11,606,981
Motor vehicles	4,881,158	336,746	(20,479)	5,197,425
Computer equipment	2,465,395	311,547	(64,717)	2,712,225
Aircraft	709,207	-	-	709,207
Furniture, equipment and machinery	<u>2,738,813</u>	<u>170,551</u>	<u>(20,554)</u>	<u>2,888,810</u>
	38,719,890	919,584	(2,481,750)	37,157,724
Less accumulated depreciation	<u>(17,468,520)</u>	<u>(1,584,074)</u>	<u>1,808,550</u>	<u>(17,244,044)</u>
	<u>\$ 21,251,370</u>	<u>\$ (664,490)</u>	<u>\$ (673,200)</u>	<u>\$ 19,913,680</u>

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

President's office	\$ 39,218
External affairs and LNOs	4,852
Health, education and social affairs	254,692
Economic affairs	41,223
Transportation, communication and infrastructure	499,269
Finance and administration	43,024
Justice	407,366
Office of the Public Defender	17,265
Judiciary	26,937
Legislature	170,234
Office of the Public Auditor	17,792
National government programs	38,103
Boards, commissions and other	<u>24,099</u>
	<u>\$ 1,584,074</u>

**(6) Long-term Obligations**

**Primary Government**

Asian Development Bank (ADB) Loan Number 1257 FSM (SF) - Fisheries Development Project Loan (SDR 3,792,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing January 15, 2004 in an amount of SDR 46,100 increasing to SDR 92,400 on January 15, 2014, with a maturity date of July 15, 2033.

\$ 5,045,593

ADB Loan Number 1459 FSM (SF) - Water Supply and Sanitation Project Loan (SDR 7,233,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2007 in an amount of SDR 69,200, increasing to SDR 138,500 on February 1, 2017, with a maturity date of August 1, 2036.

9,108,517

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

(6) Long-term Obligations, Continued

Primary Government, Continued

<p>ADB Loan Number 1520 FSM (SF) - Public Sector Reform Program Loan (SDR 12,979,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2008 in an amount of SDR 129,800, increasing to SDR 259,600 on February 1, 2018, with a maturity date of August 1, 2037.</p>	17,682,020
<p>ADB Loan Number 1816 FSM (SF) - Basic Social Services Project Loan (SDR 6,199,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2009 in an amount of SDR 129,145, at which time the service charge increases to 1.5% per annum, with a maturity date of August 1, 2032.</p>	100,000
<p>ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 3,912,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 122,250, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2025.</p>	2,500,000
<p>ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 6,273,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 130,687, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2033.</p>	<u>449,307</u>
	<u>\$ 34,885,437</u>

Annual debt service requirements to maturity for principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest and Service Charge</u>	<u>Total</u>
2005	\$ 105,634	\$ -	\$ 105,634
2006	105,634	-	105,634
2007	105,634	-	105,634
2008	287,804	-	287,804
2009	645,611	-	645,611
2010 - 2014	4,121,059	-	4,121,059
2015 - 2019	5,884,873	-	5,884,873
2020 - 2024	7,310,135	-	7,310,135
2025 - 2029	6,763,260	-	6,763,260
2030 - 2034	6,169,444	-	6,169,444
2035 - 2037	2,850,539	-	2,850,539
	<u>\$ 34,885,437</u>	<u>\$ -</u>	<u>\$ 34,885,437</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

**(6) Long-term Obligations, Continued**

**Primary Government, Continued**

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2004, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	Balance October 1, 2003	Additions	Reductions	Balance September 30, 2004	Due Within One Year
Loans payable:					
ADB Loan 1257 FSM (SF)	\$ 5,151,227	\$ -	\$ (105,634)	\$ 5,045,593	\$ 105,634
ADB Loan 1459 FSM (SF)	9,115,019	-	(6,502)	9,108,517	-
ADB Loan 1520 FSM (SF)	17,682,020	-	-	17,682,020	-
ADB Loan 1816 FSM (SF)	-	100,000	-	100,000	-
ADB Loan 1873 FSM (SF)	1,850,000	650,000	-	2,500,000	-
ADB Loan 1874 FSM (SF)	112,578	336,729	-	449,307	-
	<u>33,910,844</u>	<u>1,086,729</u>	<u>(112,136)</u>	<u>34,885,437</u>	<u>105,634</u>
Other:					
Compensated absences	666,736	221,855	(249,436)	639,155	239,118
	<u>\$ 34,577,580</u>	<u>\$ 1,308,584</u>	<u>\$ (361,572)</u>	<u>\$ 35,524,592</u>	<u>\$ 344,752</u>

**Discretely Presented Component Units**

As of September 30, 2004, the discretely presented component units had the following long-term debt outstanding:

**FSM Telecommunications Corporation (FSMTC)**

Loan with the Rural Utilities Service (RUS) (formerly the Rural Electrification Administration) from the Rural Electrification and Telephone Revolving Fund, dated August 1, 1990 of \$39.6 million, with interest at 5% per annum, unconditionally guaranteed by the FSM National Government, under which the FSM National Government will make debt service payments to RUS in the event of default by FSMTC. Mortgages over specific FSMTC ground leases and essentially all assets of FSMTC have collateralized both loans.

\$ 25,963,658

**National Fisheries Corporation (NFC)**

Notes payable to the FSM National Government, due in various annual installments of \$1,962 to \$86,639, non-interest bearing, and due on various dates ranging from July 2007 through April 2014.

3,600,000

**\$ 29,563,658**

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2004

**(6) Long-term Obligations, Continued**

Discretely Presented Component Units, Continued

Annual the debt service requirements to maturity for principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest and Service Charge</u>	<u>Total</u>
2005	\$ 4,310,137	\$ 1,298,183	\$ 5,608,320
2006	745,644	1,262,676	2,008,320
2007	782,926	1,225,394	2,008,320
2008	822,072	1,186,248	2,008,320
2009	863,176	1,145,144	2,008,320
2010 - 2014	5,008,073	5,033,527	10,041,600
2015 - 2019	6,391,710	3,649,890	10,041,600
2020 - 2024	8,157,622	1,883,978	10,041,600
2025 - 2026	<u>2,482,298</u>	<u>154,020</u>	<u>2,636,318</u>
	<u>\$ 29,563,658</u>	<u>\$ 16,839,060</u>	<u>\$ 42,802,718</u>

Changes in long-term liabilities of the discretely presented component units for the year ended September 30, 2004, are as follows:

	<u>Balance October 1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2004</u>	<u>Due Within One Year</u>
Loans payable:					
FSMTC	\$ 26,654,002	\$ -	\$ (690,344)	\$ 25,963,658	\$ 710,137
NFC	<u>3,600,000</u>	<u>-</u>	<u>-</u>	<u>3,600,000</u>	<u>3,600,000</u>
	<u>\$ 30,254,002</u>	<u>\$ -</u>	<u>\$ (1,538,034)</u>	<u>\$ 29,563,658</u>	<u>\$ 4,310,137</u>

**(7) Operating Transfers In/Out**

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2004, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>Major Governmental Funds</u>			
General	Compact Trust	\$ 3,710,819	\$ 3,710,819
General	Nonmajor governmental funds	514,083	-
Nonmajor governmental funds	General	-	426,208
Nonmajor governmental funds	Compact Trust	<u>-</u>	<u>4,304,181</u>
		<u>4,224,902</u>	<u>8,441,208</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(7) Operating Transfers In/Out, Continued

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>Nonmajor Governmental Funds</u>			
General	Nonmajor governmental funds	-	514,083
Nonmajor governmental funds	General	426,208	-
Nonmajor governmental funds	Compact Trust	<u>4,304,181</u>	<u>-</u>
		<u>4,730,389</u>	<u>514,083</u>
		<u>\$ 8,955,291</u>	<u>\$ 8,955,291</u>

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid. During the year ended September 30, 2004, the FSM National Government made a one-time transfer of \$3,710,819 from the General Fund and \$4,304,181 from nonmajor governmental funds to the Compact Trust Fund representing the establishment of the Trust Fund in accordance with Section 215 of the Compact of Free Association.

(8) Contingencies and Commitments

Sick Leave

It is the policy of the FSM National Government to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2004 is \$666,736.

Insurance Coverage

The FSM National Government does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the FSM National Government may be self-insured to a material extent.

Federal Grants

The FSM National Government participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$3,783,567 relating to fiscal years 1999 through 2004 have been set forth in the FSM National Government's Single Audit Report for the year ended September 30, 2004. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements. In addition, a material amount of questioned costs exists from the four States, which receive federal funds in a subrecipient capacity. If these questioned costs are sustained, such will be funded by State resources.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

(8) Contingencies and Commitments, Continued

Federal Grants, Continued

Pursuant to Title I, Section 105 of United States Public Law 99-290, the FSM National Government is no longer liable for debts to U.S. federal agencies arising prior to the date of the implementation of the Compact of Free Association. This matter has not yet been officially resolved with the U.S. Government. Accordingly, the States have made no adjustment to the above questioned costs for amounts which were incurred prior to the implementation of the Compact of Free Association.

Leases

The FSM National Government has entered into house lease agreements varying from one to five years. The aggregate amount of future lease payments has not been accumulated as renewal is subject to annual appropriation.

Litigation

The FSM National Government is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the FSM National Government is of the opinion that the probable outcome of suits existing at September 30, 2004, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$0.

Asian Development Bank (ADB) Loans

On December 20, 2000, the FSM National Government entered into a loan agreement (Loan Number 1816 FSM (SF)) with the ADB for the Basic Social Services Project in the amount of \$8,019,000. The purpose of the loan is to design and introduce reform in the health and education sectors in the FSM, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2004, the FSM National Government had drawn down \$100,000 against this loan.

On December 12, 2001, the FSM National Government entered into two loan agreements (Loan Numbers 1873 FSM (SF) and 1874 FSM (SF)) with the ADB for the Private Sector Development Project in the amounts of \$5,000,000 and \$8,017,000, respectively. The purpose of these loans is to promote economic growth by expanding the private sector in the FSM, thereby raising domestic employment and incomes and reducing dependence on external assistance, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2004, the FSM National Government had drawn down \$2,949,307 against these loans. During fiscal year 2006, both of these loan accounts were fully drawn down and closed.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2004

**(9) Individual Deficit Fund Balances/Net Assets**

Specific individual funds that had significant individual deficit fund balances/net assets as at September 30, 2004, are as follows:

Major governmental funds

Early Retirement Program Fund	\$ <u>139,545</u>
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Nonmajor governmental funds

Employees' Health Insurance Plan Fund	\$ <u>1,094,122</u>
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Component Units

National Fisheries Corporation	\$ <u>2,727,815</u>
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**(10) Subsequent Event**

On November 5, 2004, the FSM National Government entered into two loan agreements (Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF)) with the Asian Development Bank in the combined amount of \$19,000,000 for the Omnibus Infrastructure Development Project. The proceeds are to be used to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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**REQUIRED SUPPLEMENTARY INFORMATION-  
OTHER THAN MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**YEAR ENDED SEPTEMBER 30, 2004**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Revenues, Expenditures and Changes in Deficit - Budget and Actual  
General Fund  
Year Ended September 30, 2004

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	Variance with Final Budget -
	<u>Original</u>	<u>Final</u>		Positive (Negative)
<b>Revenues:</b>				
Taxes	\$ 8,525,000	\$ 8,460,700	\$ 9,532,728	\$ 1,072,028
Fishing rights	11,000,000	12,000,000	12,067,418	67,418
Postal revenues	525,000	460,000	485,421	25,421
Investment earnings	-	1,100,000	2,604,465	1,504,465
Fees and charges	80,000	89,000	188,277	99,277
Other	700,000	500,000	782,180	282,180
<b>Total revenues</b>	<u>20,830,000</u>	<u>22,609,700</u>	<u>25,660,489</u>	<u>3,050,789</u>
<b>Expenditures:</b>				
<b>General government:</b>				
Executive Branch	8,220,881	8,062,973	7,728,312	334,661
Judicial Branch	897,767	320,680	305,902	14,778
Legislative Branch	3,660,160	3,099,446	2,775,876	323,570
Office of the Public Auditor	-	-	(10,346)	10,346
Other National Government Programs	3,210,057	3,540,562	3,249,049	291,513
Boards and Commissions	1,194,708	1,140,542	1,093,876	46,666
Payments to Component Units	733,534	733,534	729,874	3,660
Other Legislative Appropriations	2,800,000	2,800,000	1,994,260	805,740
Other	-	-	499,716	(499,716)
<b>Total expenditures</b>	<u>20,717,107</u>	<u>19,697,737</u>	<u>18,366,519</u>	<u>1,331,218</u>
<b>Excess of revenues over expenditures</b>	<u>112,893</u>	<u>2,911,963</u>	<u>7,293,970</u>	<u>4,382,007</u>
<b>Other financing sources (uses):</b>				
Operating transfers in	200,000	200,000	426,208	226,208
Operating transfers out	(1,514,083)	(1,514,083)	(4,224,902)	(2,710,819)
<b>Total other financing sources (uses), net</b>	<u>(1,314,083)</u>	<u>(1,314,083)</u>	<u>(3,798,694)</u>	<u>(2,484,611)</u>
<b>Net change in deficit</b>	<u>(1,201,190)</u>	<u>1,597,880</u>	<u>3,495,276</u>	<u>1,897,396</u>
<b>Other changes in unreserved deficit:</b>				
Increase in reserve for related assets	-	-	(573,203)	(573,203)
Increase in reserve for continuing appropriations	-	-	(1,776,005)	(1,776,005)
<b>Unreserved deficit at the beginning of the year</b>	<u>(2,410,559)</u>	<u>(2,410,559)</u>	<u>(2,410,559)</u>	<u>-</u>
<b>Unreserved deficit at the end of the year</b>	<u>\$ (3,611,749)</u>	<u>\$ (812,679)</u>	<u>\$ (1,264,491)</u>	<u>\$ (451,812)</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Required Supplementary Information - Budgetary Reporting  
September 30, 2004

(1) Budgetary Information

The Congress of the Federated States of Micronesia (CFSM) enacts the budget through passage of specific departmental appropriations. Before signing the Appropriations Act, the President may veto or reduce any specific appropriation, subject to Congressional override. Under the Compact of Free Association, which went into effect November 3, 1986, approval of all CFSM Laws is vested with the President of the Federated States of Micronesia.

During fiscal year 2004, supplemental appropriations were also made for both operating and capital purposes, to reflect the evolving priorities of the FSM National Government.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes, may be effected by CFSM approval.

Formal budget integration is employed as a management control device during the year for all funds. The Congress of the FSM has the authority to reprogram budgeted estimates in accordance with the Constitution. All annual appropriations lapse at fiscal year end unless otherwise specified by law. Supplemental appropriations may occur throughout the year. Unexpended encumbrances at each fiscal year end are carried forward until they are expended or canceled without further legislative action.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the basic financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement.

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

For the year ended September 30, 2004, expenditures of the General Fund exceeded budget at the program area level (i.e., the legal level of budgetary control) as follows:

<u>Program Area</u>	<u>Excess</u>
Department of Finance and Administration	\$ 51,599
Other	\$ 499,716

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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**OTHER SUPPLEMENTARY INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2004**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**GENERAL FUND**  
Statement of Revenues, Expenditures by Function and Department,  
and Changes in Fund Balance  
Year Ended September 30, 2004  
(with comparatives for the year ended September 30, 2003)

	2004	2003
<b>Revenue:</b>		
<b>Compact Funding:</b>		
Base amount	\$ -	\$ 4,403,160
Inflation adjustment	-	2,553,833
	-	6,956,993
<b>Local taxes:</b>		
Import	2,840,467	1,949,024
Fuel	160,692	138,328
Income tax, individuals, net of tax refunds	3,073,616	2,318,022
Gross receipts tax, businesses	3,457,953	1,702,278
	9,532,728	6,107,652
<b>Fees, licenses, and other</b>		
Fishing rights fees	12,067,418	11,817,041
Postal collections	485,421	410,743
Business license and firearms fees	186,926	123,009
Penalties and interest on delinquent taxes	1,351	87,660
Other	782,180	118,550
	13,523,296	12,557,003
<b>Investment earnings:</b>		
Net increase in the fair value of investments	604,465	2,522,803
Dividend and interest income	2,000,000	140,487
	2,604,465	2,663,290
<b>Total revenues</b>	25,660,489	28,284,938
<b>Expenditures:</b>		
<b>Executive Branch:</b>		
President's Office	692,066	688,956
Department of External Affairs and LNO's	3,200,428	3,822,846
Department of Health, Education and Social Affairs	294,868	937,472
Department of Economic Affairs	106,440	1,151,381
Department of Transportation, Communication and Infrastructure	645,590	729,842
Department of Finance and Administration	998,836	2,311,745
Department of Justice	1,275,547	2,313,517
Office of the Public Defender	574,522	486,349
	7,788,297	12,442,108
<b>Judicial Branch</b>	334,671	1,071,180

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

GENERAL FUND

Statement of Revenues, Expenditures by Function and Department,  
and Changes in Fund Balance, Continued

Year Ended September 30, 2004

(with comparatives for the year ended September 30, 2003)

	2004	2003
Expenditures, continued:		
Legislative Branch:		
Office of the Speaker	763,529	791,280
Congress staff	992,227	1,012,730
Delegation offices	340,976	366,274
Members' travel fund	477,412	541,823
Legislative committees	19,579	136,787
Total Legislative Branch	2,593,723	2,848,894
Office of the Public Auditor	31,591	372,699
Other National Government Programs	3,386,211	3,461,163
Boards and Commissions:	1,108,500	1,186,176
Payments to Component Units:		
College of Micronesia-FSM	513,000	3,250,000
FSM Coconut Development Authority	216,055	278,533
National Fisheries Corporation OPIC loan	-	145,000
	729,055	3,673,533
Other Legislative appropriations	2,107,867	3,661,196
Other	499,271	11,352
Total expenditures	18,579,186	28,728,301
Excess (deficiency) of revenues over (under) expenditures	7,081,303	(443,363)
Other financing sources (uses):		
Operating transfers in:		
Passport Revolving Fund	426,208	335,040
Operating transfers out:		
Maritime Operations Revolving Fund	(514,083)	(821,598)
Compact Trust Fund	(3,710,819)	-
Total other financing sources (uses), net	(3,798,694)	(486,558)
Net change in fund balance	3,282,609	(929,921)
Fund balance at the beginning of the year	18,999,244	19,929,165
Fund balance at the end of the year	\$ 22,281,853	\$ 18,999,244

See Accompanying Independent Auditors' Report.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**GENERAL FUND**  
Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit) -  
Budget and Actual, Budgetary Basis  
Year Ended September 30, 2004

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
<b>Revenues:</b>				
Local taxes	\$ 8,525,000	\$ 8,460,700	\$ 9,532,728	\$ 1,072,028
Fishing right fees	11,000,000	12,000,000	12,067,418	67,418
Postal revenues	525,000	460,000	485,421	25,421
Investment earnings	-	1,100,000	2,604,465	1,504,465
Fees and charges	80,000	89,000	188,277	99,277
Other	700,000	500,000	782,180	282,180
Total revenues	<u>20,830,000</u>	<u>22,609,700</u>	<u>25,660,489</u>	<u>3,050,789</u>
<b>Expenditures-budgetary basis by department:</b>				
<b>Executive Branch:</b>				
Office of the President	500,457	538,881	523,526	15,355
Disaster Office	44,246	40,221	37,631	2,590
Public Information	126,161	121,161	119,227	1,934
Total	<u>670,864</u>	<u>700,263</u>	<u>680,384</u>	<u>19,879</u>
<b>Department of External Affairs:</b>				
Administration	275,765	300,765	294,578	6,187
Division of APA and Multilateral Affairs	95,869	75,987	75,698	289
Division of American and European Affairs	77,172	62,172	55,716	6,456
FSM Consulate - Guam	244,810	244,810	244,137	673
FSM Consulate - Honolulu	231,300	207,300	200,132	7,168
FSM Embassy - Tokyo	884,578	884,578	863,202	21,376
FSM Embassy - Washington D.C.	745,258	745,258	663,014	82,244
FSM Embassy - Fiji	196,156	196,156	193,776	2,380
FSM Permanent Mission - New York	543,994	597,994	627,956	(29,962)
Total	<u>3,294,902</u>	<u>3,315,020</u>	<u>3,218,209</u>	<u>96,811</u>
<b>Department of Health, Education and Social Affairs:</b>				
Administration	95,717	100,817	101,490	(673)
Division of Health	-	-	(165)	165
Division of Education	-	-	(8,905)	8,905
Archive and Historic Preservation Unit	101,507	83,555	84,837	(1,282)
Environmental	-	-	(2,616)	2,616
Women's Interests Unit	45,032	45,032	43,103	1,929
Sports and Youth Unit	85,028	79,928	78,354	1,574
Total	<u>327,284</u>	<u>309,332</u>	<u>296,098</u>	<u>13,234</u>
<b>Department of Economic Affairs</b>				
Administration	117,912	100,895	84,611	16,284
Division of Sectoral Development	-	-	(978)	978
Planning and Economic Management	-	-	(1,500)	1,500
Public Enterprise Unit	-	-	(3,468)	3,468
Statistics	-	-	(12,423)	12,423
Agriculture	-	-	(755)	755
Fisheries	-	-	(118)	118
Environmental and Sustainable Development	-	-	(3,129)	3,129
Total	<u>117,912</u>	<u>100,895</u>	<u>62,240</u>	<u>38,655</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**GENERAL FUND**  
Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit) -  
Budget and Actual, Budgetary Basis, Continued  
Year Ended September 30, 2004

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Department of Transportation, Communication and Infrastructure:				
Administration	132,984	129,394	131,330	(1,936)
Division of Marine Transportation	81,831	81,831	81,312	519
Division of Infrastructure	294,847	294,847	293,463	1,384
Civil Aviation	79,984	77,619	78,421	(802)
Communication	71,750	71,750	69,547	2,203
Total	<u>661,396</u>	<u>655,441</u>	<u>654,073</u>	<u>1,368</u>
Department of Finance and Administration:				
Administration	146,785	196,748	190,298	6,450
Division of National Treasury & Investment	-	-	88,625	(88,625)
Division of Customs and Tax Administration	-	-	(30,976)	30,976
Division of Budget	-	-	1,035	(1,035)
Division of Personnel	76,962	91,962	92,043	(81)
Recruitment and Repatriation	98,700	98,700	101,553	(2,853)
Staff Housing	520,114	505,114	501,545	3,569
Total	<u>842,561</u>	<u>892,524</u>	<u>944,123</u>	<u>(51,599)</u>
Department of Justice:				
Administration	161,278	161,278	138,772	22,506
Division of Law	-	-	(667)	667
Division of Litigation	-	-	1,504	(1,504)
Division of Immigration and Labor	-	-	(11,161)	11,161
FSM National Police	1,628,379	1,385,915	1,234,211	151,704
Total	<u>1,789,657</u>	<u>1,547,193</u>	<u>1,362,659</u>	<u>184,534</u>
Office of the Public Defender				
	516,305	542,305	510,526	31,779
Total Executive Branch	<u>8,220,881</u>	<u>8,062,973</u>	<u>7,728,312</u>	<u>334,661</u>
Judicial Branch				
	897,767	320,680	305,902	14,778
Legislative Branch:				
Office of the Speaker	1,605,200	924,700	910,548	14,152
Congress staff	1,094,246	1,245,746	1,048,206	197,540
Delegation offices	420,000	388,286	307,281	81,005
Members' travel fund	431,000	431,000	492,680	(61,680)
Legislative committees	109,714	109,714	17,161	92,553
Total Legislative Branch	<u>3,660,160</u>	<u>3,099,446</u>	<u>2,775,876</u>	<u>884,284</u>
Office of the Public Auditor				
	-	-	(10,346)	10,346
Other National Government Programs:				
Aid to Nonpublic School	500,000	500,000	500,000	-
Micronesia Legal Services Corporation	150,000	150,000	150,000	-
JCN	180,000	335,593	547,903	(212,310)
FY2004 Energy Funding	300,000	300,000	300,000	-
Boarder Managemnet System	160,000	160,000	162,356	(2,356)
National Election Director	237,850	300,573	245,880	54,693
Aquaculture Center	91,833	236,647	207,296	29,351
Other	1,590,374	1,557,749	1,135,614	422,135
Total Other National Government Programs	<u>3,210,057</u>	<u>3,540,562</u>	<u>3,249,049</u>	<u>291,513</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

GENERAL FUND

Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit) -  
Budget and Actual, Budgetary Basis, Continued  
Year Ended September 30, 2004

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Board and Commissions:				
Micronesian Maritime Authority	380,787	341,602	340,719	883
FSM Banking Board	138,384	123,403	104,212	19,191
Board of Regents - COM	25,000	25,000	25,000	-
Postal services	612,537	612,537	603,238	9,299
National Board of Nursing	38,000	38,000	20,707	17,293
Total Boards and Commissions	<u>1,194,708</u>	<u>1,140,542</u>	<u>1,093,876</u>	<u>46,666</u>
Payments to component units:				
Copra Subsidy	100,000	100,000	100,000	-
Coconut Development Authority	115,534	115,534	116,874	(1,340)
COM-FSM	518,000	518,000	513,000	5,000
Total Payments to Component Units	<u>733,534</u>	<u>733,534</u>	<u>729,874</u>	<u>3,660</u>
Other Legislative Appropriations:				
Public projects - National Government	2,800,000	2,800,000	1,994,260	805,740
Other	-	-	499,716	(499,716)
Total expenditures	<u>20,717,107</u>	<u>19,697,737</u>	<u>18,366,519</u>	<u>1,891,932</u>
Excess of revenues over expenditures	<u>112,893</u>	<u>2,911,963</u>	<u>7,293,970</u>	<u>4,382,007</u>
Other financing sources (uses):				
Operating transfers in:				
Passport Revolving Fund	200,000	200,000	426,208	226,208
Operating transfers out:				
Compact Trust Fund	1,000,000	1,000,000	3,710,819	(2,710,819)
Maritime Revolving Fund	514,083	514,083	514,083	-
	<u>1,514,083</u>	<u>1,514,083</u>	<u>4,224,902</u>	<u>(2,710,819)</u>
Total other financing sources (uses), net	<u>(1,314,083)</u>	<u>(1,314,083)</u>	<u>(3,798,694)</u>	<u>(2,484,611)</u>
Net change in unreserved fund deficit	(1,201,190)	1,597,880	3,495,276	1,897,396
Unreserved fund deficit at beginning of year	(2,410,559)	(2,410,559)	(2,410,559)	-
Other changes in unreserved fund deficit:				
Increase in reserve for related assets	-	-	(573,203)	(573,203)
Increase in reserve for continuing appropriations	-	-	(1,776,005)	(1,776,005)
Unreserved deficit at end of year	<u>\$ (3,611,749)</u>	<u>\$ (812,679)</u>	<u>\$ (1,264,491)</u>	<u>\$ (451,812)</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combined Balance Sheet  
Nonmajor Governmental Funds  
September 30, 2004

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
<b><u>ASSETS</u></b>			
Cash and cash equivalents	\$ 31,541	\$ -	\$ 31,541
Equity in internal investment pool	3,713,137	-	3,713,137
Investments	-	3,832,273	3,832,273
Receivables, net:			
Federal agencies	-	726,755	726,755
Loans	-	1,228,636	1,228,636
Accrued interest	-	10,446	10,446
Other	6,086	-	6,086
Due from other funds	2,316,031	-	2,316,031
Advances	29,342	32,060	61,402
Other assets	192,204	-	192,204
	<u>\$ 6,288,341</u>	<u>\$ 5,830,170</u>	<u>\$ 12,118,511</u>
<b><u>LIABILITIES AND FUND BALANCES</u></b>			
<b>Liabilities:</b>			
Accounts payable	\$ 695,700	\$ 42,809	\$ 738,509
Other liabilities and accruals	1,805,360	-	1,805,360
Due to FSM State Governments	952,266	9,455	961,721
Due to other funds	181,641	1,820,539	2,002,180
Deferred revenue	-	75,358	75,358
	<u>3,634,967</u>	<u>1,948,161</u>	<u>5,583,128</u>
<b>Fund balances:</b>			
<b>Reserved for:</b>			
Related assets	-	5,060,909	5,060,909
Encumbrances	779,660	524,444	1,304,104
Continuing appropriations	682,332	1,324,872	2,007,204
Compact programs	1,364,150	-	1,364,150
<b>Unreserved (deficit):</b>			
Special revenue funds	(172,768)	-	(172,768)
Capital projects funds	-	(3,028,216)	(3,028,216)
	<u>2,653,374</u>	<u>3,882,009</u>	<u>6,535,383</u>
Total liabilities and fund balances	<u>\$ 6,288,341</u>	<u>\$ 5,830,170</u>	<u>\$ 12,118,511</u>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combined Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances  
Nonmajor Governmental Funds  
Year Ended September 30, 2004

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:			
Interest and dividends	\$ 305,778	\$ -	\$ 305,778
Fees and charges	4,826,677	-	4,826,677
Other grants	306,325	-	306,325
Other	37,750	-	37,750
Total revenues	5,476,530	-	5,476,530
Expenditures by function:			
Current:			
General government:			
Health, education and social affairs	6,066,594	-	6,066,594
Transportation, communication and infrastructure	11,859	-	11,859
Economic affairs	910,697	-	910,697
Justice	16,042	-	16,042
Payments to component units	475,000	500,000	975,000
Capital projects	-	484,836	484,836
Total expenditures	7,480,192	984,836	8,465,028
Excess of revenues over expenditures	(2,003,662)	(984,836)	(2,988,498)
Other financing sources (uses):			
Operating transfers in	514,083	-	514,083
Operating transfers out	(2,005,749)	(2,724,640)	(4,730,389)
Total other financing sources (uses), net	(1,491,666)	(2,724,640)	(4,216,306)
Net change in fund balances	(3,495,328)	(3,709,476)	(7,204,804)
Fund balances at the beginning of the year	6,148,702	7,591,485	13,740,187
Fund balances at the end of the year	\$ 2,653,374	\$ 3,882,009	\$ 6,535,383

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Balance Sheet  
September 30, 2004**

	Section 215(a)(2) Communications	Section 215(b)(2) Communications	Section 216(a)(1) Marine Surveillance	Section 216(b)(1) Marine Surveillance	Section 216(a)(2) Health and Medical	Section 216(a)(3) Post-secondary Education	Section 221(b) Special Block Grant	Section 214 Energy	Section 212 Special Development	Maritime Operations Revolving
<b>ASSETS</b>										
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Equity in internal investment pool	233,875	402,073	392,606	47,487	298,769	728,958	279,634	194,754	-	-
Receivables, net:										
Other	-	-	-	-	-	-	-	-	-	3,102
Due from other funds	-	-	-	-	-	-	-	-	-	178,931
Advances	-	-	-	-	-	-	-	-	-	10,115
Other assets	-	-	-	-	-	-	-	-	-	-
<b>Total assets</b>	<b>\$ 233,875</b>	<b>\$ 402,073</b>	<b>\$ 392,606</b>	<b>\$ 47,487</b>	<b>\$ 298,769</b>	<b>\$ 728,958</b>	<b>\$ 279,634</b>	<b>\$ 194,754</b>	<b>\$ -</b>	<b>\$ 192,148</b>
<b>LIABILITIES AND FUND BALANCES</b>										
<b>(DEFICITS)</b>										
Liabilities:										
Accounts payable	\$ -	\$ 1,060	\$ 174	\$ -	\$ 4,850	\$ 76,406	\$ 56,283	\$ -	\$ -	\$ 39,016
Other liabilities and accruals	-	-	-	-	-	-	-	-	-	1,652
Due to FSM State Governments	-	-	-	-	-	-	-	-	-	-
Due to other funds	-	-	-	-	-	-	-	-	-	-
<b>Total liabilities</b>	<b>\$ -</b>	<b>\$ 1,060</b>	<b>\$ 174</b>	<b>\$ -</b>	<b>\$ 4,850</b>	<b>\$ 76,406</b>	<b>\$ 56,283</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 40,668</b>
Fund balances (deficits):										
Reserved for:										
Encumbrances	10,162	7,312	335,479	-	30,494	5,000	71,874	-	-	69,337
Continuing appropriations	-	146,881	-	-	-	276,144	18,575	173,312	-	-
Compact programs	223,713	246,820	56,953	47,487	263,425	371,408	132,902	21,442	-	-
Unreserved (deficit)	-	-	-	-	-	-	-	-	-	82,143
<b>Total fund balances (deficits)</b>	<b>\$ 233,875</b>	<b>\$ 401,013</b>	<b>\$ 392,432</b>	<b>\$ 47,487</b>	<b>\$ 293,919</b>	<b>\$ 652,552</b>	<b>\$ 223,351</b>	<b>\$ 194,754</b>	<b>\$ -</b>	<b>\$ 151,480</b>
<b>Total liabilities and fund balances</b>	<b>\$ 233,875</b>	<b>\$ 402,073</b>	<b>\$ 392,606</b>	<b>\$ 47,487</b>	<b>\$ 298,769</b>	<b>\$ 728,958</b>	<b>\$ 279,634</b>	<b>\$ 194,754</b>	<b>\$ -</b>	<b>\$ 192,148</b>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Balance Sheet, Continued  
September 30, 2004**

	Non-U.S. Grants	Disaster Relief	Passport Revolving	Fisheries Observer Revolving	Medical Revolving	Aquaculture Revolving	Student Loans	Nurse Board Revolving	Health Insurance Plan	Total
<b>ASSETS</b>										
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 31,541	\$ 31,541
Equity in internal investment pool	-	-	-	-	-	-	-	-	1,134,981	3,713,137
Receivables, net:										
Other	-	-	-	-	-	-	-	-	2,984	6,086
Due from other funds	970,855	125,648	47,516	343,757	4,616	37,061	596,492	11,155	-	2,316,031
Advances	18,677	-	-	-	-	-	-	-	550	29,342
Other assets	-	-	-	-	-	-	-	-	192,204	192,204
<b>Total assets</b>	<b>\$ 989,532</b>	<b>\$ 125,648</b>	<b>\$ 47,516</b>	<b>\$ 343,757</b>	<b>\$ 4,616</b>	<b>\$ 37,061</b>	<b>\$ 596,492</b>	<b>\$ 11,155</b>	<b>\$ 1,362,260</b>	<b>\$ 6,288,341</b>

**LIABILITIES AND FUND BALANCES  
(DEFICITS)**

<b>Liabilities:</b>										
Accounts payable	\$ 36,342	\$ -	\$ 7,516	\$ 3,020	\$ -	\$ -	\$ -	\$ -	\$ 471,033	\$ 695,700
Other liabilities and accruals	-	-	-	-	-	-	-	-	1,803,708	1,805,360
Due to FSM State Governments	952,266	-	-	-	-	-	-	-	-	952,266
Due to other funds	-	-	-	-	-	-	-	-	181,641	181,641
<b>Total liabilities</b>	<b>\$ 988,608</b>	<b>\$ -</b>	<b>\$ 7,516</b>	<b>\$ 3,020</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,456,382</b>	<b>\$ 3,634,967</b>
<b>Fund balances (deficits):</b>										
Reserved for:										
Encumbrances	148,337	-	17,304	83,747	614	-	-	-	-	779,660
Continuing appropriations	-	67,420	-	-	-	-	-	-	-	682,332
Compact programs	-	-	-	-	-	-	-	-	-	1,364,150
Unreserved (deficit)	(147,413)	58,228	22,696	256,990	4,002	37,061	596,492	11,155	(1,094,122)	(172,768)
<b>Total fund balances (deficits)</b>	<b>\$ 924</b>	<b>\$ 125,648</b>	<b>\$ 40,000</b>	<b>\$ 340,737</b>	<b>\$ 4,616</b>	<b>\$ 37,061</b>	<b>\$ 596,492</b>	<b>\$ 11,155</b>	<b>\$ (1,094,122)</b>	<b>\$ 2,653,374</b>
<b>Total liabilities and fund balances</b>	<b>\$ 989,532</b>	<b>\$ 125,648</b>	<b>\$ 47,516</b>	<b>\$ 343,757</b>	<b>\$ 4,616</b>	<b>\$ 37,061</b>	<b>\$ 596,492</b>	<b>\$ 11,155</b>	<b>\$ 1,362,260</b>	<b>\$ 6,288,341</b>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances (Deficits)  
Year Ended September 30, 2004**

	Section 215(a)(2) Communications	Section 215(b)(2) Communications	Section 216(a)(1) Marine Surveillance	Section 216(b)(1) Marine Surveillance	Section 216(a)(2) Health and Medical	Section 216(a)(3) Post-secondary Education	Section 221(b) Special Block Grant	Section 214 Energy	Section 212 Special Development	Maritime Operations Revolving
Revenues:										
Interest and dividends	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Fees and charges	-	-	-	-	-	-	-	-	-	138,484
Other grants	-	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-	-	-
Total revenues	-	-	-	-	-	-	-	-	-	138,484
Expenditures by function:										
Current:										
General government:										
Health, education and social affairs	-	-	-	-	1,570	361,033	65,461	-	-	-
Transportation, communication and infrastructure	-	11,859	-	-	-	-	-	-	-	-
Economic affairs	-	-	30,434	-	-	-	-	-	-	829,807
Justice	-	-	-	-	-	-	-	-	-	-
Payments to component units	-	-	-	-	-	475,000	-	-	-	-
Total expenditures	-	11,859	30,434	-	1,570	836,033	65,461	-	-	829,807
Excess (deficiency) of revenues over (under) expenditures	-	(11,859)	(30,434)	-	(1,570)	(836,033)	(65,461)	-	-	(691,323)
Other financing sources (uses):										
Operating transfers in	(1,094,573)	(8,000)	-	-	-	-	-	-	-	514,083
Operating transfers out	(1,094,573)	(8,000)	-	-	-	-	(346,462)	(130,506)	-	-
Total other financing sources (uses),	(1,094,573)	(8,000)	-	-	-	-	(346,462)	(130,506)	-	514,083
Net change in fund balances (deficit	(1,094,573)	(19,859)	(30,434)	-	(1,570)	(836,033)	(411,923)	(130,506)	-	(177,240)
Fund balances (deficits) at the beginning of the year	1,328,448	420,872	422,866	47,487	295,489	1,488,585	635,274	325,260	-	328,720
Fund balances (deficits) at the end of the year	\$ 233,875	\$ 401,013	\$ 392,432	\$ 47,487	\$ 293,919	\$ 652,552	\$ 223,351	\$ 194,754	\$ -	\$ 151,480

See Accompanying Independent Auditors' Report



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances (Deficits), Continued  
Year Ended September 30, 2004**

	Non-U.S. Grants	Disaster Relief	Passport Revolving	Fisheries Observer Revolving	Medical Revolving	Aquaculture Revolving	Student Loans	Nurse Board Revolving	Health Insurance Plan	Total
Revenues:										
Interest and dividends	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 305,778	\$ 305,778
Fees and charges	-	-	442,250	115,186	-	1,908	-	1,060	4,127,789	4,826,677
Other grants	306,325	-	-	-	-	-	-	-	-	306,325
Other	-	-	-	-	-	-	-	-	37,750	37,750
Total revenues	306,325	-	442,250	115,186	-	1,908	-	1,060	4,471,317	5,476,530
Expenditures by function:										
Current:										
General government:										
Health, education and social affairs	306,324	-	-	-	-	-	1,747	-	5,330,459	6,066,594
Transportation, communication and infrastructure	-	-	-	-	-	-	-	-	-	11,859
Economic affairs	-	-	-	50,456	-	-	-	-	-	910,697
Justice	-	-	16,042	-	-	-	-	-	-	16,042
Payments to component units	-	-	-	-	-	-	-	-	-	475,000
Total expenditures	306,324	-	16,042	50,456	-	-	1,747	-	5,330,459	7,480,192
Excess (deficiency) of revenues over (under) expenditures	1	-	426,208	64,730	-	1,908	(1,747)	1,060	(859,142)	(2,003,662)
Other financing sources (uses):										
Operating transfers in	-	-	-	-	-	-	-	-	-	514,083
Operating transfers out	-	-	(426,208)	-	-	-	-	-	-	(2,005,749)
Total other financing sources (uses),	-	-	(426,208)	-	-	-	-	-	-	(1,491,666)
Net change in fund balances (deficit	1	-	-	64,730	-	1,908	(1,747)	1,060	(859,142)	(3,495,328)
Fund balances (deficits) at the beginning	923	125,648	40,000	276,007	4,616	35,153	598,239	10,095	(234,980)	6,148,702
Fund balances (deficits) at the end	924	125,648	40,000	340,737	4,616	37,061	596,492	11,155	(1,094,122)	2,653,374

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
CAPITAL PROJECTS FUNDS**

Combining Balance Sheet  
September 30, 2004

	Compact Capital Projects	OIA Capital Projects	Total
<b><u>ASSETS</u></b>			
Investments	\$ 3,832,273	\$ -	\$ 3,832,273
Receivables, net:			
Federal agencies	-	726,755	726,755
Loans	1,228,636	-	1,228,636
Interest	10,446	-	10,446
Advances	32,060	-	32,060
	<u>\$ 5,103,415</u>	<u>\$ 726,755</u>	<u>\$ 5,830,170</u>
 <b><u>LIABILITIES AND FUND BALANCES</u></b>			
Liabilities:			
Accounts payable	\$ 42,809	\$ -	\$ 42,809
Due to FSM State Governments	9,455	-	9,455
Due to other funds	1,247,964	572,575	1,820,539
Deferred revenue	-	75,358	75,358
Total liabilities	<u>1,300,228</u>	<u>647,933</u>	<u>1,948,161</u>
Fund balances:			
Reserved for:			
Related assets	5,060,909	-	5,060,909
Encumbrances	524,444	-	524,444
Continuing appropriations	1,256,925	67,947	1,324,872
Unreserved (deficit)	<u>(3,039,091)</u>	<u>10,875</u>	<u>(3,028,216)</u>
Total fund balances	<u>3,803,187</u>	<u>78,822</u>	<u>3,882,009</u>
Total liabilities and fund balances	<u>\$ 5,103,415</u>	<u>\$ 726,755</u>	<u>\$ 5,830,170</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
CAPITAL PROJECTS FUNDS**

**Combining Statement of Expenditures by Function,  
and Changes in Fund Balances  
Year Ended September 30, 2004**

	<u>Compact Capital Projects</u>	<u>OIA Capital Projects</u>	<u>Total</u>
Expenditures by function:			
Payments to component units	\$ 500,000	\$ -	\$ 500,000
Capital projects	484,836	-	484,836
Total expenditures	<u>984,836</u>	<u>-</u>	<u>984,836</u>
Other financing uses:			
Operating transfers out	<u>(2,724,640)</u>	<u>-</u>	<u>(2,724,640)</u>
Net change in fund balances	(3,709,476)	-	(3,709,476)
Fund balances at the beginning of the year	<u>7,512,663</u>	<u>78,822</u>	<u>7,591,485</u>
Fund balances at the end of the year	<u>\$ 3,803,187</u>	<u>\$ 78,822</u>	<u>\$ 3,882,009</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**SECTION 211 COMPACT SECTOR FUNDS**

Combining Balance Sheet  
September 30, 2004

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Total
<u>ASSETS</u>						
Due from other governments	\$ 693,055	\$ 15,852	\$ 11,030	\$ 288,145	\$ -	\$ 1,008,082
Due from other funds	675,943	7,145	2,274	-	5,458	690,820
	<u>\$ 1,368,998</u>	<u>\$ 22,997</u>	<u>\$ 13,304</u>	<u>\$ 288,145</u>	<u>\$ 5,458</u>	<u>\$ 1,698,902</u>
 <u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ 1,338,436	\$ 24,445	\$ 12,950	\$ 123,823	\$ 3,581	\$ 1,503,235
Due to other funds	-	-	-	187,366	-	187,366
Total liabilities	<u>1,338,436</u>	<u>24,445</u>	<u>12,950</u>	<u>311,189</u>	<u>3,581</u>	<u>1,690,601</u>
Fund balances (deficit):						
Reserved for:						
Encumbrances	60,356	27,178	21,340	168,605	6,879	284,358
Unreserved	(29,794)	(28,626)	(20,986)	(191,649)	(5,002)	(276,057)
Total fund balances (deficit)	<u>30,562</u>	<u>(1,448)</u>	<u>354</u>	<u>(23,044)</u>	<u>1,877</u>	<u>8,301</u>
Total liabilities and fund balances	<u>\$ 1,368,998</u>	<u>\$ 22,997</u>	<u>\$ 13,304</u>	<u>\$ 288,145</u>	<u>\$ 5,458</u>	<u>\$ 1,698,902</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**SECTION 211 COMPACT SECTOR FUNDS**

**Combining Statement of Expenditures by Account,  
and Changes in Fund Balances (Deficit)  
Year Ended September 30, 2004**

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Total
<b>Revenues:</b>						
Compact funding	\$ 4,296,489	\$ 477,195	\$ 438,609	\$ 3,861,224	\$ 62,820	\$ 9,136,337
<b>Expenditures by function:</b>						
<b>Current:</b>						
<b>General government:</b>						
Health, education and social affairs	1,265,927	478,643	-	-	60,943	1,805,513
Economic affairs	-	-	438,255	314,615	-	752,870
Finance	-	-	-	1,208,580	-	1,208,580
Justice	-	-	-	1,269,818	-	1,269,818
Judiciary	-	-	-	641,500	-	641,500
Office of Public Auditor	-	-	-	404,439	-	404,439
Payments to component units	3,000,000	-	-	-	-	3,000,000
Other	-	-	-	45,316	-	45,316
<b>Total expenditures</b>	<u>4,265,927</u>	<u>478,643</u>	<u>438,255</u>	<u>3,884,268</u>	<u>60,943</u>	<u>9,128,036</u>
<b>Net change in fund balances (deficit)</b>	30,562	(1,448)	354	(23,044)	1,877	8,301
<b>Fund balances at the beginning of the year</b>	-	-	-	-	-	-
<b>Fund balances (deficit) at the end of the year</b>	<u>\$ 30,562</u>	<u>\$ (1,448)</u>	<u>\$ 354</u>	<u>\$ (23,044)</u>	<u>\$ 1,877</u>	<u>\$ 8,301</u>

See Accompanying Independent Auditors' Report.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Honorable Joseph J. Urusemal  
President  
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2004, and have issued our report thereon dated August 14, 2006, which report was qualified due to: (1) our inability to determine the propriety of cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information; and (2) the lack of audited financial statements of the National Fisheries Corporation, Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

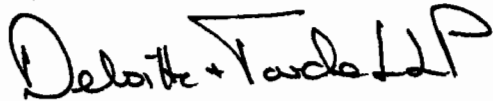
In planning and performing our audit, we considered the FSM National Government's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we considered to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the FSM National Government's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 81 through 157) as items 2004-09 and 2004-16 through 2004-39.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2004-17, 2004-18, 2004-20, 2004-21, 2004-24, 2004-30, and 2004-37 through 2004-39 to be material weaknesses.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FSM National Government's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-01, 2004-07 and 2004-21.

This report is intended solely for the information and use of the FSM National Government, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

August 14, 2006

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND ON THE  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Honorable Joseph J. Urusemal  
President  
Federated States of Micronesia:

Compliance

We have audited the compliance of the Federated States of Micronesia (FSM) National Government with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2004. The FSM National Government's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 81 through 157). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the FSM National Government's management. Our responsibility is to express an opinion on the FSM National Government's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the FSM National Government's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the FSM National Government's compliance with those requirements.

As described in items 2004-01 through 2004-15 in the accompanying Schedule of Findings and Questioned Costs, the FSM National Government did not comply with requirements regarding allowable costs/cost principles, cash management, eligibility, procurement, reporting, program income, and special tests and provisions that are applicable to its major programs as described in the Federal Award Findings and Questioned Cost Section of the Schedule of Findings and Questioned Costs. Compliance with such requirements is necessary, in our opinion, for the FSM National Government to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the FSM National Government complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2004.



### Internal Control Over Compliance

The management of the FSM National Government is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the FSM National Government's internal control over compliance with the requirements that could have a direct and material effect on major federal programs in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

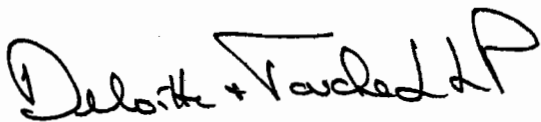
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the FSM National Government's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-01 through 2004-15 and 2004-21.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2004-07 and 2004-21 to be material weaknesses.

### Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the FSM National Government as of and for the year ended September 30, 2004, and have issued our report thereon dated August 14, 2006, which report was qualified due to: (1) our inability to determine the propriety of cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information; and (2) the lack of audited financial statements of the National Fisheries Corporation, Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. Our audit was performed for the purpose of forming an opinion on the respective financial statements that collectively comprise the FSM National Government's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 70 through 77) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the FSM National Government. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to substantiate receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the FSM National Government, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

August 14, 2006

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Summary Schedule of Expenditures of Federal Awards, by Grantor  
Year Ended September 30, 2004

<u>Agency/Program</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. Department of Agriculture	\$ 29,205	\$ 233,310
U.S. Department of Commerce	877,792	-
U.S. Department of the Interior	11,782,660	50,296,833
U.S. Department of Labor	1,798,343	737,792
U.S. Department of Homeland Security	265,244	3,554,755
U.S. Department of Education	2,717,040	2,195,757
U.S. Department of Health and Human Services	<u>2,873,485</u>	<u>1,033,724</u>
 GRAND TOTAL	 <u>\$ 20,343,769</u>	 <u>\$ 58,052,171</u>

Note: All grant awards are received from the respective grantor agencies in a direct capacity.

Reconciliation to the financial statements:		
Expenditures for U.S. Federal Grants	\$ 9,285,540	
Expenditures for Compact Sector Grants	9,128,036	
Expenditures for Compact CIP Fund	984,836	
Expenditures for Compact All Other Funds	<u>945,357</u>	
Total expenditures per financial statements	<u>\$ 20,343,769</u>	

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2004

<u>Agency/Program</u>		<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF AGRICULTURE				
Cooperative Forestry Assistance	343319	10.664	\$ <u>29,205</u>	\$ <u>233,310</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL			\$ <u><u>29,205</u></u>	\$ <u><u>233,310</u></u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2004

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF COMMERCE			
Anadromous Fish Conservation Act Program	11.405	\$ -	\$ -
Special Oceanic and Atmospheric Projects -NOAA	453897/443898/453899 11.460	<u>877,792</u>	<u>-</u>
U.S. DEPARTMENT OF COMMERCE		<u>\$ 877,792</u>	<u>\$ -</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2004

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF THE INTERIOR			
Economic, Social and Political Development of the Territories and the Freely Associated States:			
	15.875		
Compact Current Account	7611	\$ -	\$ -
Compact Capital Account	50	984,836	6,373,097
Compact Energy Grant	27	-	648,238
Compact Communications-Annual	21	-	-
Compact Communications-One Time	22	11,859	-
Compact Marine Surveillance-Annual	23	30,434	-
Compact Health and Medical 216(a)	24	1,570	31,791
Compact Post Secondary Education	25	836,033	169,156
Compact Special Block Grant 221(b)	15	65,461	135,399
Compact Special Development		-	(7,453)
Compact II Infrastructure Sector	68	-	35,827
Compact II Education Sector	72	4,265,927	19,283,030
Compact II Health Sector	73	478,643	12,589,183
Compact II Capacity	74	3,884,268	6,290,470
Compact II Environment	75	60,943	1,500,966
Compact II Private Sector	76	438,255	2,744,358
Technical Assistance:	373616-377349		
Single Audit		410,335	-
Other Technical Assistance		270,845	350,441
		<u>11,739,409</u>	<u>50,144,503</u>
Total CFDA #15.875			
Historic Preservation Fund Grants-In-Aid	377535/377536	15.904	43,251
			<u>152,330</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 11,782,660</u>	<u>\$ 50,296,833</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2004

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF LABOR			
School to Work Program	17.249	\$ 172,378	\$ 28,917
Job Training Partnership Act	17.250	-	11,598
WIA Administration	323194 17.255	1,625,965	73,943
WIA Adult Program	17.258	-	196,451
WIA Youth Activities	17.259	-	194,299
WIA Dislocated Worker	17.260	<u>-</u>	<u>232,584</u>
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 1,798,343</u>	<u>\$ 737,792</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2004

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
<b>U.S. DEPARTMENT OF HOMELAND SECURITY</b>			
Public Assistance Projects		83.516 \$ 5,077	\$ 780,987
El Nino HMGP Projects	443815	97.067 -	-
Typhoon Fern HMGP/Subgrantee	443886	83.544 2,787	-
FY03 Counseling Program	443888	97.032 41,626	-
FEMA 1427-DR-FSM/Public Assistance	443889	97.036 67,276	1,449,743
FEMA 1427/IFG Admin. Cost	443892	97.050 127,598	-
FEMA 1449 DR-FM Grantee Admin	443893	97.036 20,880	1,324,025
<b>U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL</b>		<b>\$ 265,244</b>	<b>\$ 3,554,755</b>

See accompanying notes to Schedule of Expenditures of Federal Awards.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2004

<u>Agency/Program</u>		<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF EDUCATION				
Special Education - Grants to States	303041/303054	84.027B	\$ 1,684,335	\$ 2,194,555
Public Library Services (LSCA - Title I)	303048	84.034	-	-
Adult Education-State Grant Program	303040/303053	84.002A	63,928	-
Byrd Honors Scholarship	307747	84.185A	33,000	-
Bilingual Education	313050	84.195	-	-
Goal 2000 Program	303051	84.276A	-	945
Career Res. Ntwk State Grants	303052	84.346A	67,666	-
Teacher Quality Enhancement	303056	84.336A	<u>868,111</u>	<u>257</u>
U.S. DEPARTMENT OF EDUCATION TOTAL			<u>\$ 2,717,040</u>	<u>\$ 2,195,757</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2004

<u>Agency/Program</u>		<u>Federal</u>	<u>Expenditures</u>	<u>Amounts</u> <u>Passed-Through</u> <u>to</u> <u>Subrecipients</u>
		<u>CFDA Number</u>		
<b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES</b>				
State System Development Initiative	417549	93.110	\$ 75,199	\$ -
Project Grants and Cooperative Agreements for Tuberculosis				
Control Programs	417542	93.116	113,956	59,201
AIDS Surveillance	417543	93.118	15,072	-
FYO3 School Health (YRBS HIV Prevention)	303060	93.126	25,227	-
Hansen's Disease Naitonal Ambulatory Care Program		93.215	-	1,424
Family Planning	417557	93.217	292,937	88,283
Community Health Centers		93.224	147,614	180,664
Vaccination and Immunization for Children Grants	413575	93.268	499,088	130,624
Tobacco Use Prevention	417537/413536	93.283	25,752	51,650
HIV Care Project	417556	93.917	61,409	-
HIV Prevention Activities-Health Department Based (HIV Prevention Program)	417551	93.940	158,078	34,595
HIV/AIDS Title III		93.918	853	-
Block Grants for Community Mental Health Services (CMHS Block Grant)	417645	93.958	-	-
Block Grants for Prevention and Treatment of Substance Abuse (Prevention and Treatment (SAPT) Block Grant)	413566/417535/417550	93.959	363,140	239,959
Preventive Health Services - Sexually Transmitted Diseases Control Grants	417653	93.977	32,497	14,775
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	417559	93.988	134,178	36,272
Preventive Health and Health Services Block Grant	413792/413538/413560	93.991	37,448	2,035
Maternal and Child Health Services Block Grant to the States	417547,417558,417000,417533	93.994	258,283	179,688
Public Health Prep/Bioterrorism	413537	93.283	632,754	14,554
Grants to Provide Outpatient Early Intervention Services with respect to HIV Disease	417661	93.918	-	-
<b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL</b>			<b>\$ 2,873,485</b>	<b>\$ 1,033,724</b>
<b>GRAND TOTAL</b>			<b>\$ 20,343,769</b>	<b>\$ 58,052,171</b>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2004

1. Scope of Audit

The Federated States of Micronesia (FSM) is a governmental entity governed by its own Constitution. All significant operations of the FSM are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the FSM's cognizant agency for Single Audit. All programs are received in a direct capacity from the specified grantor agency.

a. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Department of Homeland Security
- U.S. Department of Commerce

2. Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed which help illustrate the expenditures of the individual programs. All expenses and capital outlays are reported as expenditures. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

B. Reporting Entity

The FSM National Government, for purposes of the general purpose financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity."

C. Indirect Cost Allocation

The FSM National Government did not receive an indirect cost allocation and did not charge indirect costs against federal programs in fiscal year 2004.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2004

2. Summary of Significant Accounting Policies, Continued

D. Subgrantees

Certain program funds are passed through the FSM National Government to subrecipients. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all subgrantees outside of the FSM National Government's control utilize these funds. However, the FSM National Government's primary subrecipients are its four component states. Per the recommendation of the U.S. Department of the Interior, Office of Inspector General (OIG), the federal expenditures of these entities that were passed through from the FSM National Government are incorporated in the accompanying Schedule of Expenditures of Federal Awards. Direct U.S. federal awards received by the four States are not included in the accompanying Schedule. The OIG recommendation also extended to include subrecipient findings related to funds passed through by the FSM National Government to its four States. Therefore, such findings have been extracted from the four separate State A-133 Single audits and are included in the accompanying Schedule of Findings and Questioned Costs.

Single Audit Excluded Funding

For purposes of the Single Audit, Compact Section 211(a) Current Account Funding and Compact Section 215 Current Account Funding have been excluded from the dollar threshold used to distinguish between Type A and Type B programs. The requirement to exclude such funding was recommended by the U.S. Department of the Interior, Office of the Inspector General (OIG). The OIG took this position since there are no compliance requirements imposed on the abovementioned funds.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Programs  
Selected for audit in accordance with  
OMB Circular A-133  
Year Ended September 30, 2004

<u>Grantor</u>	<u>Description</u>	<u>CFDA No.</u>	<u>Amount of 2004 Expenditures</u>
U.S. Dept. of the Interior:	Compact of Free Association: 211(a) Capital Account	15.875	\$ 984,836
	Compact II Sector Grants	15.875	9,128,036
	Single Audit	15.875	410,335
U.S. Dept. of Labor	WIA Administration	17.255	1,625,965
	School to Work Program	17.249	172,378
U.S. Dept. of Education	Special Education – Grants to States	84.027	1,684,335
	Teacher Quality Enhancement Grants	84.336A	868,111
U.S. Dept. of Health and Human Services	Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	<u>658,506</u>
	Total program expenditures selected		\$ <u>15,532,502</u>
	Total U.S. Federal Program expenditures		\$ <u>20,343,769</u>
	% of Total U.S. Federal expenditures covered by major programs		<u>76%</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2004

**Part I - Summary of Auditors' Results**

1. The Independent Auditors' Report on the basic financial statements expressed a qualified opinion due to (1) our inability to determine the propriety of cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information; and (2) the lack of audited financial statements of the National Fisheries Corporation, Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc.
2. Reportable conditions in internal control over financial reporting were identified, some of which were considered to be material weaknesses.
3. Instances of noncompliance considered material to the basic financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, some of which were considered to be material weaknesses.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The FSM National Government's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Economic Social and Political Development of the Territories and the Freely Associated States:	15.875
211(a) Capital Account	
Compact II Sector Grants	
Single Audit	
WIA Administration	17.255
School to Work Program	17.249
Special Education: Grants to States	84.027
Teacher Quality Enhancement Grants	84.336A
Centers for Disease Control and Prevention – Investigations and Technical Assistance	93.283

8. A threshold of \$610,313 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The FSM National Government did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Part II - Financial Statement Findings Section**

<u>Reference No.</u>	<u>Findings</u>	<u>Questioned Costs</u>
2004-09	Program Income	\$ -
2004-16	Untimely Deposits	\$ -
2004-17	Travel Advances	\$ -
2004-18	Untimely Reversal of Advances	\$ -
2004-19	Unidentified Collections	\$ -
2004-20	Unsupported Cash Reconciling Items	\$ -
2004-21	Reconciliation of Federal Program Receivables	\$ -
2004-22	AP of Chuuk CIP Account	\$ -
2004-23	Encumbrance and Improper Charging of Account	\$ -
2004-24	Unaccounted ADB Loan Proceeds	\$ -
2004-25	Annual Leave Forms and Calculation	\$ -
2004-26	Independent Checks	\$ -
2004-27	ADB Reconciliation	\$ -
2004-28	Public Law – Employment Ceiling	\$ -
2004-29	Fixed Assets	\$ -
2004-30	Monitoring of Receivable Billing and Collection	\$ -
2004-31	Unavailability of Documents for Review	\$ -
2004-32	Collection Effort on Bank Errors	\$ -
2004-33	Untimely Liquidation of Representation Advances	\$ -
2004-34	Unsupported Encumbrances	\$ -
2004-35	Unsupported Expenditures	\$ -
2004-36	Encumbrance Aging	\$ -
2004-37	Unreimbursed Federal Expenditures	\$ -
2004-38	Unreimbursed CFSM Projects	\$ -
2004-39	Liability Reconciliation	\$ -

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Part III - Federal Award Findings and Questioned Cost Section**

<u>Reference No.</u>	<u>CFDA #</u>	<u>Findings</u>	<u>Questioned Costs</u>
2004-01	15.875	Allowable Costs/Special Terms and Provisions	\$ 1,579,541
2004-02	15.875	Procurement and Allowable Costs/Cost Principles	\$ 23,270
2004-03	15.875	Allowable Costs/Cost Principles	\$ 454
2004-04	84.336A	Procurement	\$ 11,900
2004-05	84.336A	Allowable Costs/Cost Principles	\$ 12,000
2004-06	84.336A	Special Tests and Provisions	\$ -
2004-07	84.336A/84.027B /93.283	Cash Management	\$ -
2004-08	84.027B	Procurement and Allowable Costs/Cost Principles	\$ 98,058
2004-09	15.875	Program Income	Unknown
2004-10	17.255	Eligibility	\$ 7,561
2004-11	17.255	Reporting	\$ -
2004-12	17.255	Reporting	\$ -
2004-13	93.283	Procurement	\$ 112,628
2004-14	93.003	Allowable Costs/Principles	\$ 1,008
2004-15	93.003	Reporting	\$ -
2004-21	All major programs	Reconciliation of Federal Program Receivables	\$ -



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-01  
CFDA #: 15.875 Section 215(a) 2 Communications, Section 215(b) (2) Communications,  
Section 216 (a) (1) Surveillance, Section 216 (a) (3) Post Secondary Education  
Agency: U.S. Department of the Interior, Office of Insular Affairs  
Requirement: Allowable Costs/Special Terms and Provisions  
Questioned Costs: \$1,579,541

Criteria: Specific restrictions on the use of Compact of Free Association funding should be complied with unless specific written concurrence is obtained from the grantor agency.

Condition: During fiscal year 2004, the FSM National Government transferred \$1,579,541 of cash to the Section 215 Trust Fund that was established pursuant to the amended Compact of Free Association. The following funds established pursuant to the original Compact of Free Association were charged for the amount transferred:

Section 215(a)(2) – Communications	\$1,094,573
Section 215(b)(2) Communications	\$ 8,000
Section 221(b) Special Block Grant	\$ 346,462
Section 214 Energy	\$ 130,506

Each of these funds is restricted for its original purpose and the grantor has opined that such restrictions remain and the funds are to be expended for their original purpose.

Cause: It appears that the FSM National Government considered the restrictions on these funds to be lifted as the above transfer occurred pursuant to FSM Public Law.

Effect: The effect of this condition is twofold:

1. The above costs are questioned as they are not eligible costs as defined by the Compact of Free Association and do not meet the special conditions imposed by that agreement.
2. The financial position of the General Fund may be overstated by \$1,579,541. If this transfer is to be charged to the general fund, a deficit in the general fund will result.

Recommendation: We believe that the grantor agency may have provided written communication to the FSM National Government concerning the restrictions imposed on the use of the above funds. We therefore recommend that this matter be resolved with the grantor agency.

Auditee Response and Correction Action Plan: We agree with this finding.

The transfer of cash amounting to \$1,579,541 to section 215 FSM Trust Fund was executed pursuant to FSM Public law 12-74. We will refer this to Attorney General for advice.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-02  
 CFDA #: 15.875 Economic, Social, and Political Development of the Territories and the Freely Associated States, Compact of Free Association Sector Grants  
 Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Grant #: CSG-FSM-2004-EDU-CR, CSG-FSM-2004-HLT-CR, CSG-FSM-2004-CAP  
 Requirement: Procurement and Allowable Costs/Cost Principles  
 Questioned Costs: \$23,270

Criteria: The Compact of Free Association Sector Grants requires that competitive procurement activities occur in accordance with U. S. federal requirements and that documentation be on hand that supports the relevancy of the expenditure to the program.

Condition: For two of 33 (6%) non-payroll expenditures (\$15,629 of the aggregate amount of \$261,052 tested), there were no procurement documents on file evidencing the procurement rationale for the following:

ORG	DESCR-1	DESCR-2	ACTUALS	Check #
741090	JVA0377	MA2024	\$11,887	17,773
741031	JVA0097	NA410A	3,742	17179

For one of 33 (3%) non-payroll expenditures (\$2,586 of the aggregate amount of \$261,052 tested), based on available data, it was not possible to determine if the expenditure was reasonable and/or necessary for the program since the agenda or purpose of the conference was not documented.

ORG	DESCR-1	DESCR-2	ACTUALS	Check #
721072	400515501	MA4393	\$2,586	19165

For one of 33 (3%) non-payroll expenditures (\$5,055 of the aggregate amount of \$261,052 tested), the accounts payable voucher (which includes relevant invoices, receiving reports, purchase orders and contracts) substantiating the relevancy of the expenditure to the program was not available:

ORG	DESCR-2	ACTUALS
741032	MA5323	\$5,055

Cause: There appears to be a lack of controls over ensuring compliance with the criteria.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-02, Continued  
CFDA #: 15.875 Economic, Social, and Political Development of the Territories and the Freely Associated States, Compact of Free Association Sector Grants  
Agency: U.S. Department of the Interior, Office of Insular Affairs  
Grant #: CSG-FSM-2004-EDU-CR, CSG-FSM-2004-HLT-CR, CSG-FSM-2004-CAP  
Requirement: Procurement and Allowable Costs/Cost Principles  
Questioned Costs: \$23,270

Effect: The grantee appears to be in noncompliance with applicable U. S. federal procurement requirements and should ensure that documentation is on file to substantiate that such procurement occurred and the relevancy of the expenditure to the program. Furthermore, questioned costs result.

Recommendation: The FSM National Government should follow U. S. federal procurement requirements and document justification for selection rationale. Also, the FSM National Government should exercise more stringent document policies to ensure all expenditure transactions can be substantiated.

Auditee Response and Corrective Action Plan: We agree with this finding.

The fiscal year 2004 represents the first year of the implementation of the Amended Compact. Funding under the Amended Compact did not become available until after the first two months of the fiscal year. The entire National Government operations for the first two months were funded under our FSM Government general fund. Fund certification and disbursements followed the generally accepted procedures and guidelines for expending FSM government general fund.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-03  
 CFDA #: 15.875 Economic, Social, and Political Development of the Territories and the Freely Associated States, Compact of Free Association Sector Grants  
 Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Grant #: CSG-FSM-2004-EDU-CR, CSG-FSM-2004-HLT-CR  
 Requirement: Allowable Costs/Cost Principles  
 Questioned Costs: \$454

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, approved personnel action forms and timesheets should reflect balances contained in the payroll register.

Condition: For one of 24 (4%) payroll expenditures (\$50 of the aggregate amount of \$15,260 tested), hours per timesheets do not agree with hours per the payroll register.

<u>CK #</u>	<u>PPE</u>	<u>EMP#</u>	<u>HOURS PER TIMESHEET</u>	<u>HOURS PER PAYROLL REGISTER</u>	<u>Difference in \$</u>
312341	23 03	72170	72RG, 19HO, 12OT	72RG, 8HO, 11HL, 12OT	\$50

For one of 24 (8%) payroll expenditures (\$91 of the aggregate amount of \$15,260 tested), the pay rate per the personnel action form does not agree with the pay rate per the register. We also note that the personnel action form on file is only a photocopy and the pay rate was inserted via an unattributed alteration.

<u>CK #</u>	<u>PPE</u>	<u>EMP#</u>	<u>PAYRATE PER PAF</u>	<u>PAYRATE PER REGISTER</u>	<u>Difference</u>
324127	09 04	78748	312.86/BW	365.66/BW	\$53
331275	16 04	35389	390.40/BW	428.86/BW	38

For one of 24 (4%) payroll expenditures (\$313 of the aggregate amount of \$15,260 tested), the personnel action form was not provided.

<u>CK #</u>	<u>PPE</u>	<u>EMP#</u>	<u>GROSS PAY</u>
329277	14 04	31301	\$313

Cause: There appears to be a lack of controls over the maintenance and storage of relevant financial and programmatic records.

Effect: The grantee may be in noncompliance with the criteria. The above matters are questioned since the projected questioned costs exceed the \$10,000 threshold.

Recommendation: The FSM National Government should exercise more stringent document policies to ensure all expenditure transactions can be substantiated and should ensure that information on personnel action forms is consistent with other authoritative payroll records.

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NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-03, Continued  
CFDA #: 15.875 Economic, Social, and Political Development of the Territories and the Freely Associated States, Compact of Free Association Sector Grants  
Agency: U.S. Department of the Interior, Office of Insular Affairs  
Grant #: CSG-FSM-2004-EDU-CR, CSG-FSM-2004-HLT-CR  
Requirement: Allowable Costs/Cost Principles  
Questioned Costs: \$454

Auditee Response and Corrective Action Plan:

1. We agree with the finding showing the \$50.00 difference in the payroll. The difference was due to the 19 hours holiday which was entered in the payroll register as 8 hours holiday without premium and 11 hours holiday with premium. Our payroll section has been instructed to advise the concerned employee for necessary adjustment in the payroll.
2. We do not agree with the finding showing the difference of \$53 with regards to the payroll of employee nos. 78748. Copy of the Personnel Action for employee 78748 shows a B/W rate of \$365.66 and this was correctly posted in the payroll register while the pay rate of employee 35389 was correctly posted in the payroll register.
3. We do not agree with this finding. The Personnel Action for employee 31301 is on file and can be reviewed anytime.

Auditor Response:

2. The Personnel Action Form is a photocopy and the pay rate is written in and no signature of an approving official was attributed to the alteration.
3. No personnel action form is available or was used in this instance. The document provided does not contain required approvals/signatures, such as from the department head, budget office, personnel office, etc.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-04  
 CFDA #: 84.336A Teacher Quality Enhancement Grants  
 Agency: U.S. Department of Education  
 Grant #: P336A020010-03  
 Requirement: Procurement  
 Questioned Costs: \$11,900

**Criteria:** The FSM National Government should comply with U. S. federal procurement policies established for States and Local Governments. Furthermore, Financial and programmatic records should be maintained on file for at least three years to substantiate expenditures.

**Condition:** For three of 31 (10%) non-payroll expenditures (\$11,900 of the aggregate amount of \$426,024 tested), there were no procurement documents on file evidencing the procurement rationale.

<u>ACCT</u>	<u>DESCR-3</u>	<u>TRN DATE</u>	<u>ACTUALS</u>	<u>CHECK#</u>	<u>Nature of Expenditures</u>
8303	MH40006	7,092,004	\$ 4,150	23146	SUPPLIES
8303	MH40006	11162004	3,150	26615	SUPPLIES
8303	L4013803	7072004	<u>4,600</u>	23146	SUPPLIES (BOOKS)
			<u>\$11,900</u>		

**Cause:** There appears to be a lack of controls over ensuring that compliance with the criteria is met.

**Effect:** The grantee appears to be in noncompliance with applicable procurement requirements and questioned costs result.

**Recommendation:** The FSM National government should follow prescribed procurement requirements and document justification for selection rationale.

**Auditee Response and Corrective Action Plan:** We do not agree with this finding.

1. Check no. 26615 was payment under Po No. N40120 issued to Chuuk Ace Hardware for supplies. Our records indicate that there were three vendors who quoted prior to selection of Chuuk Ace Hardware. The other vendors were Kurassa Store and B&J Corporation. Chuuk Ace Hardware was selected because it offers the lowest price.
2. Check no. 23146 was payment under L40138 issued to FSM College of Micronesia for books (Introduction to teaching in Micronesia, General Psychology, Human Development updated version, teachers as courses developers, refining composition skills, and bookmarks). There is only one college in FSM and that is the College of Micronesia hence it was considered as a single source.

**Auditor Response:**

1. The procurement rationale was not documented in file. Additionally, other vendors had lower prices on certain items. The audit concern is primarily with the lack of documented rationale.
2. Since the payment was for books, other vendors could have been solicited. Again, no documentation of the procurement rationale was on file.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-05  
CFDA #: 84.336A Teacher Quality Enhancement Grants  
Agency: U.S. Department of Education  
Grant #: P336A020010-03  
Requirement: Allowable Costs/Cost Principles  
Questioned Costs: \$12,000

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least three years to substantiate expenditures.

Condition: For one of 31 (3%) non-payroll expenditures (\$12,000 of the aggregate amount of \$426,024 tested), the check file (which includes relevant invoices, receiving reports, purchase orders, contracts, etc.) was not locatable.

<u>ACCT</u>	<u>DESCR-1</u>	<u>DESCR-3</u>	<u>TRN DATE</u>	<u>ACTUALS</u>	<u>Check #</u>
8210	400704601	L4010701	4292004	<u>\$12,000</u>	20608

Cause: There appears to be a lack of controls over the maintenance and storage of relevant financial and programmatic records.

Effect: The grantee may be in noncompliance with the criteria and questioned costs result.

Recommendation: The FSM National Government should exercise more stringent document policies over the maintenance and storage of financial and programmatic records.

Auditee Response and Corrective Action Plan: We agree with this finding.

Check No. 20608 was a payment made to NIHCO to purchase six (6) units of LCD projector under P.O. No. L40107. NIHCO was selected against two other vendors (Computer Consulting and Ace Office supply) because of non availability of stock. Copies of the Purchase orders, purchase requisitions and competitive prices are on file but the check file was misplaced. The Treasurer (Vicky Nimea) is instructed to locate the check file and make sure that all checks are properly filed in numerical order and that the Division of Education, Department of HESA (Emma Nelson) is instructed to justify the purchase of six (6) units of LCD projector.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-06  
CFDA #: 84.336A Teacher Quality Enhancement Grants  
Agency: U.S. Department of Education  
Grant #: P336A020010-03  
Requirement: Special Tests and Provisions – Participation of Private Schools  
Questioned Costs: \$0

Criteria: In accordance with applicable special tests and provisions requirements, any SEA, LEA, or any other educational service agency (or consortium of such agencies) receiving financial assistance under an applicable program should provide eligible private school children and their teachers or other educational personnel with equitable services or other benefits under these programs, unless otherwise exempted from this requirement.

Condition: There was no documentation provided indicating participation of private schools, and we were not provided any indication that the FSM National Government was exempted from this requirement.

Cause: There appears to be a lack of controls over conducting consultations with private schools to determine if there are eligible students who should be provided the opportunity to receive educational services under the program.

Effect: The grantee may be in noncompliance with the criteria.

Recommendation: The FSM National Government should conduct consultations with private schools to determine if there are any eligible students who should be provided the opportunity to receive educational services under the program.

Auditee Response and Corrective Action Plan:

This finding has been referred to Department of Health and Education for comment.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.:	2004-07
Agency:	U.S. Department of Education
Grant #:	H027B030002-04
CFDA#:	84.027B Special Education – Grants to the States
Program Name:	Special Education – Grants to the States
CFDA #:	84.336A Teacher Quality Enhancement Grants
Agency:	U.S. Department of Education
Grant #:	P336A020010-03
CFDA#	93.283 Centers for Disease Control and Prevention – Investigations and Technical Assistance
Agency:	U.S. Department of Health and Human Services
Grant #:	U90/CCU92181-02-1
Requirement:	Cash Management
Questioned Costs:	\$0

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the disbursement of checks should be minimized.

Condition: The FSM National Government could not provide documented details of expenditure draw downs per GAPS for the program. Based on our inquiries, it does not appear that a system is in place at the FSM National Government that conforms to U. S. federal requirements. Compounding this problem is that the National Government consolidates program information from its four States and then is required to timely reimburse its States for these payments. The current system is not sufficient for us to determine the timeliness with which such reimbursements occur nor is it sufficient to identify payments made to specific cash drawdowns.

Cause: There appears to be a lack of internal controls over cash management.

Effect: The FSM National Government appears to be in noncompliance with applicable cash management requirements. Due to lack of information available from the grantee, potential questioned costs are undeterminable.

Recommendation: The FSM National Government should establish internal controls over cash management and should establish a system that conforms to U. S federal requirements.

Prior Year Status: Cash management inadequacies were reported in the 2002 and 2003 Single audit reports.

Auditee Response and Corrective Action Plan: The method of drawdown starts upon receiving the 132-P report from the states and from the expenditure reports from the National Government. The Assistant Secretary, combine all the expenditures of the five Governments (Chuuk, Yap, Kosrae, Pohnpei and National) by fund then draw the money based on their reports. Once the money is drawdown and deposited to the National Government general fund, Federal Manager will process the transfer of the fund to all the four governments based on what is indicated in the their 132-P. On October 1, 2005, a new procedure has been implemented to properly monitor the drawdown and to properly reimbursed the states on time.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-08  
 CFDA #: 84.027B Special Education – Grants to the States  
 Agency: U.S. Department of Education  
 Grant #: H027B030002-04  
 Requirement: Procurement/Allowable Costs/Cost Principles  
 Questioned Costs: \$98,058

Criteria: Procurements should occur in accordance with U. S. federal requirements established for State and Local Governments. In addition, financial and programmatic records should be maintained on file for at least 3 years to substantiate expenditures. Furthermore, expenditure relating to the acquisition of equipment with a useful life of more than one year and acquisition cost in excess of \$5,000 per unit requires prior approval from the grantor agency.

Condition: For six of 31 (19.4%) non-payroll expenditures (\$98,058 of the aggregate amount of \$473,710 tested), there were no procurement documents on file evidencing the applicable procurement rationale. For items 5 and 6, the accounts payable voucher was not available for review. Furthermore, for items 2 and 3 there was no prior approval from the grantor agency for purchasing vehicles.

<u>Item</u>	<u>DESCR-1</u>	<u>DESCR-2</u>	<u>ACTUALS</u>	<u>Check #</u>
1	400413401	CA009602	\$ 9,446	18567
2	JVA0119	MC18-04	17,995	229715
3	JVA0253	MC32-04	22,862	233464
4	RPT.25-04	JVA0189	26,016	231645
5	JVA0300	MC08-04	20,854	235255
6	400714301	MA4590	885	20818
			<u>\$98,058</u>	

Effect: The grantee appears to be in noncompliance with applicable Federal procurement requirements and lack of controls in the maintenance and storage of relevant financial and programmatic records resulting in questioned costs.

Recommendation: The FSM National Government should follow Federal procurement requirements and document its procurement rationale. Also, the Government should exercise more stringent document polices related to the maintenance and storage of financial and programmatic records.

Auditee Response and Corrective Action Plan: We agree with this finding.

The manager at Chuuk Field Office has been instructed to provide copies of the check and the supporting documents by August 11, 2006.

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NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-09  
CFDA #: 15.875 Economic, Social, and Political Development of the Territories and the Freely Associated States, Compact of Free Association Sector Grants  
Agency: U.S. Department of the Interior, Office of Insular Affairs  
Grant #: CSG-FSM-2004-EDU-CR, CSG-FSM-2004-HLT-CR, CSG-FSM-2004-CAP  
Requirement: Program Income  
Questioned Costs: Unknown

Criteria: Revenue that derives from programs funded by sector grants should be recorded as program income of the sector grant. Approval by the grantor to recognize program income in the general fund should be documented in writing.

Condition: Revenue from billings made to private companies for overtime charges of Customs and Tax Administration and Immigration personnel was recorded as general fund revenue. However, salaries of the personnel who provided the services was funded by Sector grants. The total amount recorded for such reimbursements was \$106,091. However, certain of this amount may pertain to fiscal year 2003 billings that were recorded as 2004 revenues. The 2003 portion would not have to be reflected as program income but we are currently unable to assess the amount that relates to fiscal year 2003 services.

Cause: It is the National Government's understanding and representation that revenues are to be recorded in the general fund as verbally agreed by the U.S. representative who coordinates this program. However, no written documentation was provided to substantiate this representation.

Effect: There is a potential risk that the general fund may have inappropriately recognized revenue.

Recommendation: We recommend that the National Government reduce to writing any verbal agreements between the grantor and the entity as to how these revenues are to be recorded. Additionally, reimbursement should be recorded in the appropriate fiscal year.

Auditee Response and Corrective Action Plan: We agree with this finding.

Originally, the revenues from billings made to private companies for overtime charges of Customs and Tax administration and Immigration personnel were recorded as a credit in the overtime account of the two divisions, which represents as program revenues for the two divisions under the sector grants. However, sometime in fiscal year 2004, this matter was brought to the attention of the program coordinator, who is a representative from OIA. We had discuss with him the possibility of transferring these program revenues to the general fund for which he verbally agreed. There was no documentation on this matter but the transfer was made based on verbal agreement. The Assistant Secretary of Finance will discuss this matter again with the program coordinator and will document whatever is the outcome of discussions.

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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-10  
 CFDA#: 17.255 WIA Youth/Adult/Dislocated Workers Formula Combined  
 Agency: U.S. Department of Labor  
 Grant #: AA-13838-04-50  
 Requirement: Eligibility  
 Questioned Costs: \$7,561

**Criteria:** Programmatic records should be maintained on file for at least 3 years to substantiate eligibility for participants in the program. Adult participants should be 18 years of age or older; a dislocated worker or homemaker; and must have received at least one intensive service and meet all the following: have been interviewed, evaluated or assessed, and determined to be in need of training services and have skills to successfully complete the selected training program; selected a training service linked to the employment opportunities; and was unable to obtain grant assistance from other sources to pay the costs of the training. Youth participants are eligible if they are between the ages of 14 to 21 at the time of enrollment and demonstrate at least one of the barriers (deficient in basic literacy skills, school dropout; homeless; runaway; foster child; pregnant or parenting; offender; or an individual who requires additional assistance to complete and educational program or to secure and hold employment.

**Condition:** For 20 of 36 (56%) non-payroll expenditures tested (\$7,561 of the aggregate amount of \$384,557), no documentation has been provided to substantiate eligibility for the following program participants.

<u>FORG</u>	<u>COSTLED</u>	<u>ACCT</u>	<u>Description</u>	<u>DESCR-1</u>	<u>DESCR-2</u>	<u>Known Eligibility Question Costs</u>	<u>Contract #</u>	<u>Check #</u>
323194	TC3112	8110	FY03 XHUUK WIA (YOUTH) WIA NATL. EMERGENCY/TS	JVA0331	MC44-04	\$240	C4C116	237360
323196	TX7402	8405	CHATAAN WIA NATL. EMERGENCY/TS	JVA0300	MC38-04	581	C4C091	253306
323196	TX7402	8405	CHATAAN WIA NATL. EMERGENCY/TS	JVA0318	MC42-04	408	C4C100	236997
323196	TX7402	8405	CHATAAN WIA NATL. EMERGENCY/TS	JVA0335	MC45-04	387	C4C105	238294
323196	TX7402	8405	CHATAAN WIA NATL. EMERGENCY/TS	JVA0335	MC45-04	282	C4C092	238014
323196	TX7402	8405	CHATAAN WIA NATL. EMERGENCY/TS	JVA0335	MC45-04	282	C4C092	238011
323196	TX7402	8405	CHATAAN	JVA0342	MC46-04	194	C4C092	238891

**FEDERATED STATES OF MICRONESIA  
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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-10, Continued  
 CFDA#: 17.255 WIA Youth/Adult/Dislocated Workers Formula Combined  
 Agency: U.S. Department of Labor  
 Grant #: AA-13838-04-50  
 Requirement: Eligibility  
 Questioned Costs: \$7,561

Condition, Continued:

<u>FORG</u>	<u>COSTLED</u>	<u>ACCT</u>	<u>Description</u>	<u>DESCR-1</u>	<u>DESCR-2</u>	Known Eligibility <u>Question Costs</u>	<u>Contract #</u>	<u>Check #</u>
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0342	MC46-04	194	C4C099	238869
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0349	MC48-04	1,267	C4088,C4C088	240088
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0349	MC48-04	194	C4C088	239739
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0317	MC41-04	704	C4C088	236337
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0317	MC41-04	704	C4C091	236277
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0317	MC41-04	704	C4C094	236294
323194	TC3112	8405	FY03 XHUK WIA (YOUTH)	JVA0370	MC50-04	160	C4C116	241257
323194	TC3112	8405	FY03 XHUK WIA (YOUTH)	JVA0370	MC50-04	160	C4C116	241353
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0370	MC50-04	160	C4C116	241345
			WIA NATL. EMERGENCY/TS					
323196	TX7402	8405	CHATAAN	JVA0370	MC50-04	160	C4C116	241362
323194	TC2113	8455	FY02 CHUK WIA (DW)	JVA0251	MC28-04	300	C4C062	232530
323194	TC3112	8455	FY03 XHUK WIA (YOUTH)	JVA0325	MC43-04	240	C4C116	237212
323194	TC3112	8455	FY03 XHUK WIA (YOUTH)	JVA0325	MC43-04	<u>240</u>	C4C116	237128
						<u>\$7,561</u>		

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-10, Continued  
CFDA#: 17.255 WIA Youth/Adult/Dislocated Workers Formula Combined  
Agency: U.S. Department of Labor  
Grant #: AA-13838-04-50  
Requirement: Eligibility  
Questioned Costs: \$7,561

Cause: There appears to be a lack of controls over the maintenance and storage of relevant programmatic records to substantiate compliance with eligibility requirements.

Effect: The grantee may be in noncompliance with Federal program eligibility objectives. The above is questioned since the projected questioned cost exceeds the threshold.

Recommendation: The FSM National Government should exercise more stringent controls over document policies in the maintenance and storage of financial and programmatic records to ensure compliance with program objectives.

Auditee Response and Corrective Action Plan: We agree with this finding. Chuuk field office manager stationed in Chuuk state is instructed to provide copies of the check nos. and the supporting documents on or before August 11, 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-11  
CFDA #: 17.255 WIA Youth/Adult/Dislocated Workers Formula Combined  
Agency: U.S. Department of Labor  
Grant #: AA-13838-04-50  
Requirement: Reporting  
Questioned Costs: \$0

Criteria: In accordance with applicable federal financial reporting requirements, Form ETA-9041 Worker Adjustment Formula Financial Report, should be prepared and should be submitted.

Condition: The FSM National Government has not provided copies of the required federal financial reports for program year 2004. Therefore, we were unable to ensure that the financial information on that report was in agreement with the underlying books and records.

Cause: There appears to be weak internal controls over ensuring compliance with reporting requirements and ensuring that required reports agree with official accounting books and records.

Effect: The FSM National Government may be in noncompliance with applicable reporting requirements.

Recommendation: The FSM National Government should strengthen internal record keeping controls. Also, the FSM National Government should provide the requested federal financial reports to effect resolution of this finding.

Auditee Response and Corrective Action Plan: We agree with this finding. Under the current set up, WIA program is in charge in preparing the FSR report. WIA program manager (Iuhfert Hainrick) is instructed to mail copy of the FSR report to the auditor and provide copies of the FSR Report to the grant analyst (Erimy Alex). The program manager is further instructed to submit a quarterly report to the grant analyst.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-12  
CFDA #: 17.255 WIA Youth/Adult/Dislocated Workers Formula Combined  
Agency: U.S. Department of Labor  
Grant #: AA-13838-04-50  
Requirement: Reporting  
Questioned Costs: \$0

Criteria: In accordance with applicable federal reporting requirements, financial and performance reports should be complete and accurate.

Condition: The FSM National Government was not able to provide required financial and performance reports. Therefore, it was not possible to conclude whether reports were in agreement with underlying program financial records.

Cause: There appears to be weak internal record keeping controls over ensuring compliance with applicable reporting requirements.

Effect: The FSM National Government may be in noncompliance with applicable program reporting requirements.

Recommendation: The FSM National Government should strengthen internal record keeping controls. Also, the FSM National Government should provide the requested report to effect resolution of this finding.

Auditee Response and Corrective Action Plan: We agree with this finding. Under the current set up, WIA program is incharge in preparing the performance report. WIA program manager (Iuhfert Hainrick) is instructed to mail copy of the performance report to the auditor and provide copies of the performance report to the grant analyst (Erimy Alex). The program manager is further instructed to submit a quarterly performance report to the grant analyst.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-13  
 CFDA# 93.283 Centers for Disease Control and Prevention -- Investigations and Technical Assistance  
 Agency: U.S. Department of Health and Human Services  
 Grant #: U90/CCU92181-02-1  
 Requirement: Procurement  
 Questioned Costs: \$112,628

Criteria: In accordance with applicable federal procurement policies and procedures, the National Government should ensure that competition is maximized and the basis of its vendor selection is documented and is available for review.

Condition: For 15 of 35 (43%) non-payroll expenditures (\$112,628 of the aggregate amount of \$213,735 tested), there were no procurement documents on file evidencing the procurement rationale for the following”.

<u>DESCR-1</u>	<u>DESCR-2</u>	<u>ACTUALS</u>	<u>Check #</u>
401183801	L4027301	\$10,000	24651
400916101	MA6223	5,075	22413
401183804	L4027304	1,000	24651
400275001	CA009101	9,600	17230
400344801	CA009801	2,200	17919
400473901	MA2989	7,000	18858
400473902	MA2989	29,456	18858
400680201	CA016701	2,500	20361
401284601	MA8678	12,642	25354
400154001	C3025901	8,000	16256
400169401	JA000101	6,445	16388
401177201	CA006901	4,412	24560
400159401	CA006901	5,882	16254
400674501	CA006901	4,412	20261
400554901	N4004001	4,004	19575
	<b>TOTAL</b>	<b><u>\$112,628</u></b>	

Cause: There appears to be a lack of controls over ensuring that competition remains open among vendors.

Effect: The grantee appears to be in noncompliance with applicable procurement requirements and questioned costs result.

Recommendation: The FSM National Government should exercise more stringent document policies to ensure procurement documents are maintained on file to substantiate compliance with applicable procurement requirements. The FSM National Government should provide the requested procurement documents to effect resolution of this finding.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-13, Continued  
CFDA# 93.283 Centers for Disease Control and Prevention – Investigations and Technical Assistance  
Agency: U.S. Department of Health and Human Services  
Grant #: U90/CCU92181-02-1  
Requirement: Procurement  
Questioned Costs: \$112,628

Auditee Response and Corrective Action Plan: We agree with this finding. Check No. 24651 with testing amount of \$11,000 was a payment made to Genesis Pharmacy and Medical Clinic for medical supplies. In Pohnpei there are only two active pharmacies who are supplying medical supplies, the other one is Medpharm. The procurement section has been instructed to ensure that evidence of bidding is obtained and filed with the payment records.

We do not agree with this finding. Check No. 22413 amounting to \$5,075.40 was a payment made to Sybase Australia PTY, Ltd. for radio communication supplies. Due to the urgency of the requirement, bid quotation was not obtained. A ratification of agreement and request to record agreement as an obligation has been prepared.

We do not agree with this finding. Check Nos. 17230 & 16256 both amounting to \$17,600 were payments made to Sepehr Sohrab under special contract nos. CA0091 & C30259 to provide information on the development of software, and provide training for the National and State Governments. Because of his expertise, he was chosen to perform the service required.

We do not agree with this finding. Check No. 17919 amounting to \$2,200 represents payment made to Anna Maria Schopp under special contract no. CA0098 to direct the health education activities of the new Bioterrorism Program. Ms. Schopp was contracted as she was highly qualified for the position having received a Master's degree in disaster management from the Tulane School of Public Health and Tropical Medicine.

We do not agree with this finding. Checks Nos. 18858 and 25354 amounting to \$49,098 represent payments made to Pacific Island Health officers Association (PIHOA) The payment was made based on the memorandum of understanding between PIHOA and FSM. The MOU entered into a relationship in respect to DHESA's CDC 03-04 BT Cooperative agreement signed on 12 December 03.

We agree with this finding. Check no. 20361 amounting to \$2,500 was a payment made to Andrea S. Hillyer under contract No. CA0167 to conduct detailed assessment of the current laws and regulations relating to executing emergency public Health measures, ordinances with the states and National Government. The program manager has been instructed to ensure that evidence of bidding is obtained and filed with the payment records.

We agree with this finding. Check no. 16388 amounting to \$6,444.70 was a payment made to Pedrus Edward under Job Order No. JA0001 to work and complete the conference room for the office of HESA. The program manager has been instructed to ensure that evidence of bidding is obtained and filed with the payment records.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-13, Continued  
CFDA# 93.283 Centers for Disease Control and Prevention – Investigations and Technical Assistance  
Agency: U.S. Department of Health and Human Services  
Grant #: U90/CCU92181-02-1  
Requirement: Procurement  
Questioned Costs: \$112,628

Auditee Response and Corrective Action Plan, Continued:

We do not agree with this finding. Check nos. 2460, 16254 and 20261, totaling to \$14,706 represent payment made to Elehna Yamada for the lease rental under contract no. CA0069. The building was chosen because the rental space will provide office space for the BT grants and also for the FSM Environmental Health program for a total of ten people. The space is large enough to include a meeting room suitable for many training courses mentioned in the BT grant.

We do not agree with this finding. Check no. 19575 amounting to \$4,137.64 represent payment made to The Research Corp. of the University of Hawaii. The payment is for the six (6) polycoms. PIHOA purchased the polycoms for the FSM with the understanding that FSM would reimburse PIHOA. The Polycoms were distributed to those who attended the PITCA meeting in Honolulu, Hawaii from December 2-4, 2003.

Auditor Response: Explanations have been provided after the fact and were not documented at the time the procurement occurred. Additionally, we were not provided evidence of the consideration of other vendor choices. Therefore, based on review of the transaction detail on file, such appear to have been essentially sole-sourced without attendant rationale being documented in file. While we acknowledge that various considerations may have been made by management, the audit concern is with the lack of documentation of these considerations that should exist at the time the procurement determination is made.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-14  
Agency: U.S. Department of Homeland Security  
Grant #: U90/CCU92181-02-1  
CFDA#: 93.003  
Program Name: Bioterrorism  
Requirement: Allowable Costs/ Cost Principles  
Questioned Costs: \$1,008

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, approved Personnel Action Forms and timesheets should reflect balances contained in the payroll register.

Condition: For two of 10 (20%) payroll expenditures tested (\$1,008 of the aggregate amount of \$10,934 tested), there was an overpayment on retro payment.

<u>CK #</u>	<u>PPE</u>	<u>EMP#</u>	<u>Overpayment</u>
331755	16 04	913901	\$ 27
321729	6 04	85202	981
			<u>\$1,008</u>

Cause: There appears to be a lack of controls over the maintenance and storage of relevant financial and programmatic records.

Effect: The grantee may be in noncompliance with Federal program objectives. The above items are questioned since the projected questioned cost exceeds the \$10,000 threshold.

Recommendation: The FSM State Government should exercise more stringent document policies to prevent the disappearance of necessary supporting documentation.

Auditee Response and Corrective Action Plan: We agree to this finding.

The person in-charge has been instructed to inform the two employee and have their payroll adjusted in the next payroll.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: 2004-15  
Agency: U.S. Department of Homeland Security  
Grant #: U90/CCU92181-02-1  
CFDA: 93.003  
Program Name: Bioterrorism  
Requirement: Reporting  
Questioned Costs: \$0

Criteria: Financial Status Reports should be accurately completed and be submitted in accordance with grant terms and conditions.

Condition: Expenditures reported on the FSR (\$474,488) were less than the detailed expenditures (\$658,506) recorded for the fiscal year.

Cause: There appears to be a lack of control over the preparation and correctness of program financial reports.

Effect: The FSM National Government appears to be in noncompliance with reporting requirements.

Recommendation: The FSM National Government should comply with the Compact Sector Grant reporting requirements.

Auditee Response and Corrective Action Plan: We do not agree with this finding.

The auditor is comparing the FSR (\$474,488) as of August 30, 2004 which is eleven (11) month period against the detail expenditure as of September 30, 2004 (\$658,506) which is a twelve (12) month period.

Auditor Response: The FSM National Government could not provide FSRs for the full fiscal period. The only FSR provided were as of August 30, 2004.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-16 – Untimely Deposits

Criteria: Cash collections should be deposited the following business day.

Condition: For 20 of 62 (32%) samples tested, cash collections were not deposited in a timely manner.

CR#	Amount	Trans Date	Deposit Date
85535	\$ 800.00	11/6/03	11/10/2003
89064	\$ 10.00	6/10/04	6/15/2004
89334	\$ 50.00	6/23/04	6/28/2004
88324	\$ 50.00	4/30/04	5/4/2004
89357	\$ 50.00	6/24/04	6/28/2004
84949	\$ 149.95	10/1/03	10/3/2003
87835	\$ 44.00	3/21/04	3/25/2004
88781	\$ 950.00	5/28/04	6/8/2004
89306	\$ 78.24	6/21/04	6/23/2004
85531	\$ 75.46	11/06/03	11/10/03
87079	\$ 194,930.49	01/30/04	02/05/04
84950	\$ 6,582.37	10/01/03	10/03/03
90438	\$ 103,788.89	09/01/04	09/03/04
88161	\$ 54,523.44	04/19/04	04/22/04
88933	\$ 18,864.91	06/04/04	06/08/04
88062	\$ 77,161.77	4/08/04	04/12/04
89766	\$ 115,021.86	07/19/04	07/21/04
88300	\$ 54,684.72	04/26/04	04/30/04
89362	\$ 10,997.54	06/24/04	06/28/04
88157	\$ 32,159.56	04/16/04	04/20/04

Cause: The cause of this condition is that the cash collections were not deposited in a timely manner.

Effect: No financial statement effect results from this condition. However, failure to deposit receipts in a timely manner increases the risk of fraudulent activities.

Recommendation: The existing policy on timely deposit of collections should be observed. The deposits should be subject to management review. Deviations from the policy should be investigated to ensure that misappropriation of the collections did not occur.

Auditee Response and Corrective Action Plan: We agree with this finding.

The Treasurer has been is instructed to comply with the existing policy on timely deposit of collections and must explain any deviations from the policy, if any.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-17 – Travel Advances

Criteria:

1. Travel advances made to an employee should be supported by invoices, travel claims, contracts or other valid documentation.
2. Advances made should be posted to the proper payee.
3. In accordance with applicable Financial Management Regulations, the traveler must submit a travel claim voucher within 10 days of travel completion or of trip cancellation, and attach necessary receipts, trip reports and boarding passes or other evidence of the completion of travel. If the traveler does not liquidate the advance, alternative collection methods should be employed to recover the Government's funds.
4. In accordance with applicable Financial Management Regulations, travel advances are calculated as 80% of the total amount reported per the travel authorization.

Condition:

1. For six of fifteen (40%) travel authorizations tested, the following were not available.

<u>TA #</u>	<u>Year</u>
C20157	None indicated
CT0310	None indicated
T01415	2000
T20169	2002
T21457	2002
T30128	2003

2. For one of fifteen (7%) travel authorizations tested, the travel advance was posted to the wrong payee.

<u>TA #</u>	<u>TA Advance Amount</u>	<u>Advance Erroneously Posted</u>
T01890	\$10,620	\$620

3. For nine of fifteen (60%) travel authorizations tested, the traveler did not submit a travel claim in a timely manner and the FSM National Government has not yet liquidated the advance.

<u>TA#</u>	<u>TA Advance Amount</u>
T00024	\$4,806
T01794	\$4,855
T01890	\$10,620
T10411	\$5,788
T10115	\$7,637.98
T20167	\$7,193
T21053	\$6,285.96
T21757	\$27,128
T21762	\$15,708

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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-17 – Travel Advances, Continued

Condition, Continued:

4. For two of fifteen (13%) travel authorizations tested, the travel advance was not properly calculated.

<u>TA#</u>	<u>TA Advance Amount</u>
T21757	\$27,128
T21762	\$15,708

5. For ten of fifteen (67%) travel authorizations tested, the travel advance was not encumbered. This signifies that active collection should transpire as the encumbrance was deleted. Failure to collect the amount translates in to a bad debt.

<u>TA #</u>	<u>TA Advance Amount</u>
C20157	\$5,168
CT0310	\$4,492.65
T00024	\$4,806
T01415	\$4,375
T01794	\$4,855
T01890	\$10,620
T10115	\$7,637.98
T20169	\$7,233
T21457	\$5,403
T30128	\$6,171

Cause: There appears to be weak internal controls over travel advances.

Effect: The effect of this condition is a potential overstatement of travel advance receivables and a potential for fraud to occur.

Recommendation: We recommend that a more stringent policy be put in place governing travel advances.

Auditee Response and Corrective Action Plan:

1. We do not agree with this finding. These travel advances were issued to travelers sometime in FY90 to FY92. With the migration of the new accounting system in FY99, it is impossible to trace the copies of the checks issued prior to FY99. In addition, government policy maintained a six (6) year rule to keep the records on file to substantiate the expenditures.
2. We do not agree with this finding. Travel authorization no. T01890 was issued to Leo A. Falcam, The APV No. 90317 was under the name of Leo A. Falcam and the Check No. 184832 was under the payee named Leo A. Falcam. The travel advance was correctly posted to the subsidiary ledger under the name of Leo A. Falcam.
3. We agree with this finding. The Assistant Secretary of Finance, Division of Treasury recently issued a memorandum to all the departments to file and clear all outstanding travel advances and reconciled with the travel section any questions that they have regarding their travel accounts. A more stringent policy has been put in place governing travel advances.



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NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-17 – Travel Advances, Continued

Auditee Response and Corrective Action Plan, Continued:

4. We agree with this finding. The travel section has been instructed to be vigilant in calculating the travel advance and to strictly follow the financial management regulations.
5. We agree with this finding. These travel advances were issued to travelers sometime in FY90 to FY92. With the migration of the new accounting system in FY99, the encumbrances were not properly rolled over to the subsequent year.

Auditor Response:

1. If the travel advances are still on the books, documentation should be available to support their continued recordation.
2. The specified travel advance consists of two travel authorizations. The entity has only responded concerning one of the two and has not provided the other travel authorization.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-18 –Untimely Reversal of Advances

Criteria: Purchase and job order advances should be timely reversed and evaluated at year end as to their validity.

Condition: A number of purchase and job orders that date back from 2003 to 1994 are still recorded as advances as of September 30, 2004. Based on the aging of these purchase orders, it seems unreasonable that these items could still be outstanding for this many years. Purchase orders are to be reversed upon documentation that goods and services are received. No allowance has been provided for these purchase orders. However, a related asset was recorded by the entity for these balances.

<u>Year</u>	<u>Purchase Orders</u>	<u>Job Orders</u>	<u>Total</u>
1994	\$ -	\$ 1,400	\$ 1,400
1988	1,894	-	1,894
1989	5,398	-	5,398
1991	11,810	-	11,810
1992	16,552	-	16,552
1993	34,060	-	34,060
1994	77,265	-	77,265
1995	78,323	-	78,323
1996	90,938	39,989	130,927
1997	181,891	58,868	240,759
1998	81,757	22,329	104,086
1999	372,518	1,200	373,718
2000	67,326	1,254	68,580
2001	123,317	-	123,317
2002	59,259	-	59,259
2003	<u>315,584</u>	<u>7,716</u>	<u>323,300</u>
Total	<u>\$1,517,892</u>	<u>\$132,756</u>	<u>\$1,650,648</u>

Cause: It appears that inadequate monitoring of these advances is occurring. Additionally, due to the decentralized procurement process, Departments that receive these goods and services are not forwarding receiving reports to Finance.

Effect: This condition results in a material overstatement of assets as these items do not represent valid assets and also results in a qualification of the financial statements. These items should be expensed at the time the purchased item or service was received.

Recommendation: We recommend that an allowance be recorded for these advances. Investigation should also be performed as to the whereabouts of these advances before reversing the account to ensure accountability by the Department delegated to perform the reconciliation. Moreover, the National Government should reverse advances on a timely basis upon the receipt of the purchased item or services. Additionally, the Government should consider whether the pick up and delivery of goods and services should be centrally housed to ensure that all receiving reports are provided to Finance.

Auditee Response and Corrective Action Plan: We agree with this finding. The Division of National Treasury will communicate with the departments and conduct an investigation as to the whereabouts of these advances. An allowance for doubtful account will also be recorded in FY06.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-19 – Unidentified Collections

Criteria: Upon collection, receipts should be identified and timely remitted to the corresponding States.

Condition: As of September 30, 2004, \$476,592 of collections are not identified. A review of the detail indicates that many are from prior fiscal years.

Cause: It appears that the entity does not identify the source of its collections on a timely basis.

Effect: This amount is recorded as a payable on the National Government's books. Therefore, this condition results in untimely revenue recognition.

Recommendation: We recommend that collections initially unidentified be timely investigated and be timely remitted to the States.

Auditee Response and Corrective Action Plan: We agree with this finding. The bank reconciliation manager will look into these unidentified deposits and will properly record them in FY06.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-20 – Unsupported Cash Reconciling Items

Criteria: Bank reconciliations should be properly supported with details and those details should be readily available for review.

Condition: As of September 30, 2004, \$762,908 of cash reconciling items for the Yap and Chuuk Trust Funds was not supported by details. These items were also not reflected in the general ledger as of September 30, 2004.

Cause: Bank reconciliations have not been properly performed. Disbursements were just lumped together instead of being specifically enumerated and identified.

Effect: We cannot determine the validity of the reconciling items. As the above amount of reconciling items, which represent unrecorded revenues and receipts, is not yet reflected in the financial statements, cash and related accounts appear materially misstated, and this matter is addressed in the audit report through a qualification.

Recommendation: We recommend reconciling items be specifically identified in the bank reconciliation and that these items be cleared the following month.

Auditee Response and Corrective Action Plan: We agree with this finding. In FY06, the Yap Trust Fund and Chuuk Trust Fund were closed. Under new procedures, the three field offices in Chuuk, Kosrae, Yap will use the general fund account.

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NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-21 – Reconciliation of Federal Program Receivables – All Major Programs

Criteria: Accounts receivable from the Federal Government should be supported by details per CFDA number. Collections should then be applied against the specific CFDA number/program. This detail can be maintained apart from the general ledger system but should be regularly reconciled with related general ledger balances.

Condition: Recorded federal grants receivable are not supported by details per CFDA # or by program. There is no means of determining whether federal expenditures were completely requested for drawdown and how much of the amount has still not been collected.

Cause: It appears that there is no reconciliation of federal grants receivable per CFDA number or by program and the current system set up by the National Government is inadequate.

Effect: We cannot specifically determine the amount that should be provided as an allowance for doubtful accounts. As there is no reconciliation between actual amounts expended and collected, there is a risk that expenditures may not have been billed or drawn down. The effect of this condition is that the Government incurs a bad debt and also results in a qualification of the financial statements.

Recommendation: We recommend that federal program receivables be properly identified per CFDA number and by program and collections be specifically applied against these receivables. This will allow monitoring of uncollected balances, which should reduce future losses of the National Government in administering these programs.

Auditee Response and Corrective Action Plan: We agree with this finding. The federal program manager and the grant analyst have been instructed to look into this matter and to properly implement the recommendation made by the auditors.

**FEDERATED STATES OF MICRONESIA  
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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-22 – AP of Chuuk CIP Account

Criteria: Cash and accounts payable should be properly reconciled.

Condition: The payable amount recorded by the National Government for cash it administers on behalf of Chuuk State's Compact CIP account is equivalent to the related cash in bank balance as of September 30, 2004. The cash account is a fund that combines IFG, expenditures of which are recorded in the National Government's books, and the Compact Capital expenditures related to Chuuk, which expenditures are recorded in Chuuk State's books. As of September 30, 2005, the entity has not been able to adequately determine the amount of cash actually owed to Chuuk State.

Thus, the payable to Chuuk State should be the net balance of the accumulated actual receipts deposited to the account less related expenditures. Given that the account was commingled and that no reconciliation, per program, occurred, we are unable to determine the actual amount owed to Chuuk State.

Cause: It is the National Government's understanding that the payable to be recorded is equivalent to the cash account balance, despite the fact that the account in question is a commingled balance. We were unable to discern the reason that the account was commingled.

Effect: This condition resulted in an inability to determine the actual liability due to Chuuk State for unexpended Compact Capital account balances.

Recommendation: We recommend that the National Government extract all related Compact Capital account balances from the commingled account and determine the correct balance due to Chuuk State.

Auditee Response and Corrective Action Plan: We do not agree with this finding.

1. IFG transactions started in October 2002 and check were issued and ends on April 22, 2003. There were no checks issued for IFG after FY03, meaning all checks issued in FY04 relates to CIP projects.
2. The commingled accounts were in FY03 because both IFG and CIP used one bank account, but because of the closing of IFG in FY03 and there were no checks issued for IFG in FY04, the accounts remains for CIP in FY04.
3. The bank reconciliation as of September 30, 2004, was prepared and was submitted to the auditors before the start of the audit.
4. The adjusted cash account balance as of September 30, 2004, is the equivalent accounts payable to Chuuk State for CIP projects.

Auditor Response: We understand that a bank reconciliation of the account has been performed. However, two separate funding sources were commingled in this account. Hence, a reconciliation of those two separate funding sources should occur.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-23 - Encumbrance and Improper Charging of Account

Criteria: Contracts entered into for which services were received but not yet liquidated should be properly encumbered and be left open until requisite goods or services are complete.

Condition: Payment of check number 25090 amounting to \$24,800 for a gravel airport project was made through a direct charge. No encumbrance was liquidated for this payment as the encumbrance was already closed in a prior year upon completion of the project, although it was not yet fully paid at that time.

Furthermore, this payment was charged as an office supplies expenditure, which seems unreasonable.

Cause: We could not determine the rationale for the improper closure of the encumbrance.

Effect: The above payment resulted in the improper charging of an account name as no funding was budgeted for the payment due to improper reversal of the encumbrance.

Recommendation: We recommend that encumbrances be closed when full settlement occurs and that expenditures be properly classified in the financial statements. Moreover, reprogramming of funds should have occurred and have been properly approved instead of charging an account with an incorrect expenditure type.

Auditee Response and Corrective Action Plan: We agree with this finding.

Check no. 25090 amounting to \$24,800 represents payment for a gravel airport project which was put on hold in FY01 due to funding problems. The Purchase order no. L10305 was obligated in FY01 but because the project was put on hold for two years, the obligation was cancelled.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-24 – Unaccounted ADB Loan Proceeds

Criteria: All loan draw downs should be properly accounted for and should be recorded on a timely basis. Moreover, drawdown documents should be readily available for review.

Condition: A \$1.08 million drawdown of ADB funds in fiscal year 2004 was not timely recorded. An adjusting entry to record the drawdown was provided only in May 2006. Furthermore, no bank reconciliations, bank statements or expenditure supports were provided for the following ADB transactions and balances:

<u>Account No</u>	<u>Account Type</u>	<u>Amount</u>
131	Cash Savings	\$178,367
591030– 8408	Expenditure	\$247,015

Cause: It appears that the National Government failed to properly record the draw down and the related activity in the books of account.

Effect: The effect of this condition is that we cannot determine the validity of the above balances.

Recommendation: We recommend that the National Government monitor draw downs and record them at the time the draw down occurs. The bank reconciliation for the imprest fund should be regularly performed.

Auditee Response and Corrective Action Plan: We agree with this finding.

The accountant in-charge of ADB loans has been instructed to record all drawdown of ADB funds on a timely manner and provide a monthly bank reconciliation.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-25 – Annual Leave Forms and Calculation

Criteria: Annual leave availed by an employee should be duly approved and documented through approved annual leave forms, which should be readily available for review.

Annual leave credits for contractual employees should be based on an employment contract. Revision of annual leave credits should be properly documented through amendment of the contract or other authorizing documents.

Condition: For two of three annual leave forms tested, the requested forms were unavailable for review.

<u>Emp No</u>	<u>Annual Leave Hours with No Support</u>
2452	4
97501	40

For 2 of 6 employees, the underlying contract indicated 4 hours of annual leave credits. However, per the payroll register, the employee was credited for more than the approved hours. The entity was not able to provide the revised annual leave credits authorizing the increased hours.

<u>Emp No</u>	<u>Actual Annual Leave Credits</u>	<u>Annual Leave per Contract</u>
90242	8	4
97501	8	4

Cause: The unavailability of approved annual leave could be due to a weakness in record maintenance. The condition could also result from annual leave being utilized without proper authorization.

For annual leave credits that do not agree to contracts, there appears to be no monitoring of hours to be earned by employees. It is our understanding that the system calculates the earned credit based on accumulated employee hours since the beginning of employment. However, for employees with fixed earned annual leave credits regardless of the number of service years, the system's automatic calculation should be overridden to effect only the applicable earned hours.

Effect: When annual leave forms are unavailable, we cannot determine the validity of the annual leave balance.

The inaccurate leave credits can result in the overpayment of annual leave. For unutilized leave credits, this condition can result in an overstatement of the annual leave accrual.

Recommendation: We recommend that prior to recording annual leave, the entity ensure that leave hours are substantiated by approved forms.

For employees with fixed annual leave credits, the appropriate human resource personnel should identify these employees and should regularly monitor leave credits to ensure conformance with the approved contract. In case an employee's contract was revised, such should be properly documented and approved.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-25 – Annual Leave Forms and Calculation, Continued

Auditee Response and Corrective Action Plan: We agree with this finding.

The person in-charge of payroll has been instructed to maintain a file for all approved annual leave and file separately from the time sheets for easy reference and review.

The personnel division will revisit all contractual employees under the prime contract and requested that the contract be modified with regards to leave credits to properly document the change of annual leave credits.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-26-- Independent Checks

Criteria: The Health IF has only one staff in each of the field offices in Chuuk, Kosrae, and Yap. Cash collection reports are not being reviewed.

Condition: For 11 of 40 (28%) samples tested, cash receipt reports were not certified by someone other than the cashier.

<u>Sl'n</u>	<u>ReceiptNo</u>	<u>PayeeName</u>	<u>Total Collection</u>
1	C0091	Chuuk State Government	\$ 9,565.39
2	C0131	Chuuk State Government	12,813.74
3	K0237	Kosrae State Government	17,312.83
4	K0138	Kosrae State Government	17,626.37
5	K0047	Kosrae State Government	14,222.92
6	8862	Pohnpei State Government	33,908.49
7	Y0060	Yap State Government	5,107.66
8	C0092	Chuuk State Government	15,506.68
9	C0152	Chuuk State Government	13,644.59
10	K0070	Kosrae State Government	16,857.45
11	Y0600	Yap State Government	10,297.39

Cause: The entity's field offices appear to be understaffed and an alternative control has not been utilized.

Effect: The condition has no known material effect on the financial statements. However, the risk of cash collection being misappropriated is high.

Recommendation: We recommend that FSM - HIF have independent checks of cash collected from each field office or inquire if such collections can occur at the FSM National Government Revenue offices.

Auditee Response and Corrective Action Plan: The audit finding has been discussed and considered, however, it is not practical at this time for MiCare Plan to hire additional staff due to lesser volume of transactions being handled at the field office. Strict monitoring mechanism should be undertaken by the Plan to avoid the risk of misappropriations of cash collections. Closely monitoring of collections, reconciliation of accounts on a daily basis and confirmation of payments are being done by the fiscal Officer to ensure that all cash collections are deposited to the Plan's depository bank account.

The Plan will continue to explore other options to ensure independent checks, assigning the task to FSM National Revenue offices in each state is not workable at this time because of the fear the health insurances funds are co-mingle with general fund and the delay of remitting proceeds to the Plan for its use to meet immediate obligations.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-27 – ADB Reconciliation

Criteria: All loan transactions should be appropriately recorded in the financial statements.

Condition: We noted no reconciliation of interest and principal paid by the National Government to ADB. It appears that interest and principal paid in the current year for ADB loans were not recorded in the correct accounts as the entity could not specifically identify where or if the payments were recorded.

Moreover, loan drawdowns are not timely recorded and identified to determine proper recording.

Cause: There is no reconciliation or monitoring of payments and drawdowns of ADB loans. Payments to ADB are included in investment account activity. It appears that payments were netted against investment earnings instead of being specifically recorded as expenditures.

For loan drawdowns, there seems to be no timely communication to properly record transactions in ADB accounts.

Effect: This condition resulted in an understatement of expenditures and revenue, although it has no effect on net assets, and in improper accounting of loans between the National Government and the States. Furthermore, if all transactions are not identified, it is difficult to determine the amount of accrued interest to be recorded.

Recommendation: We recommend that payments to ADB be monitored. Furthermore, as loan balances can be accessed on line, the entity should regularly reconcile its balances. Moreover, the entity may request a confirmation from ADB prior to closing its books at year-end to ensure that all loan transactions are properly accounted for.

Auditee Response and Corrective Action Plan: We agree with this finding.

The accountant in-charge of ADB loans has been instructed to record all drawdown of ADB funds on a timely manner and provide a monthly reconciliation.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-28 – Public Law – Employment Ceiling

Criteria: As per Public Law No. 13, Section 10, the maximum number of positions for National Oceanic Resource Management Authority shall not exceed 11.

Condition: The number of positions for the National Oceanic Resource Management Authority reached 13 employees, which is more than what is allowed under the public law.

Cause: This condition may have resulted due to lack of monitoring of the number of employees.

Effect: Noncompliance with Public Law No. 13, Section 10 appears to be the effect of this condition.

Recommendation: We recommend that the agency strengthen its monitoring to ensure compliance with the criteria.

Auditee Response and Corrective Action Plan: We do not agree with this finding.

The regular employees were counted 11 and the two other employees were contractual employees for less than one year as stated in the line item budget for NORMA. These two employees were part of the budget to provides services as port sampler. The employees are exempt from the FSM National Public Service system Act, and is not entitled to any of the rights or benefits available under (52FSMC117(11).)

Auditor Response: The two referenced employees are hired under contracts that are renewed annually. Therefore, as indicated by the auditee response, they are classified as employees, which means that the position ceiling has been exceeded.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-29 – Fixed Assets

Criteria: Assets that have no future economic benefit to an entity should be written off.

Condition: For 2 of 20 (10%) fixed assets sighted, the fixed asset was no longer in good working condition.

<u>Asset #</u>	<u>Description</u>	<u>Net Asset Value</u>
2812	Ship, Micro Trader	\$336,600
2814	Ship, Micro Dawn	336,600

Cause: The root cause of this condition is weak internal controls over monitoring of assets that are no longer useful.

Effect: The net fixed asset balance was misstated by \$ 673,200. This matter was corrected through a proposed audit adjustment

Recommendation: We recommend that management strengthen its internal control over monitoring of assets.

Auditee Response and Corrective Action Plan: We agree with this finding.

The Procurement Specialist in charge of the fixed assets is currently doing an inventory of all the fixed assets and will have them classified according to the condition of the assets. Once the report is completed, the Procurement Specialist will recommend to the Secretary of Finance to survey all assets that are not in good working condition so this will be deleted from the system and the general ledger book.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-30 – Monitoring of Receivable Billing and Collection

Criteria: Billings to customers should be monitored, and collections should be specifically identified to ensure timely follow-up.

Condition: There is no specific application of collections against related billings for the receivable balances listed below. Receivables are recorded as expenditures are incurred, and the receivable is credited upon cash collection.

Account 248 and 252 also include certain mark-ups on recorded expenditures.

<u>Account</u>	<u>Account Name</u>	<u>Balance</u>
248	Reimbursable	\$ 568,370
252	AR Weather Station	\$1,076,933
259	AR Peace Corps	\$ 204,772

Cause: It is not a current practice to specifically apply collections against related billings and to reconcile the amount to the general ledger

Effect: With this scenario, an aging analysis cannot be provided. As such, we could not determine if an allowance for doubtful accounts is necessary to bring these balances to their net realizable value.

Recommendation: We recommend that receivable balances be supported by billing details and be reconciled with the general ledger. This procedure will enable preparation of an aging schedule to assist in determining if uncollectible reimbursable expenses exist.

Auditee Response and Corrective Action Plan: We agree with this finding.

The Accounts Receivable Manager will look on this matter and will follow the recommendation of the auditor.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-31 – Unavailability of Documents for Review

Criteria: All transactions should be supported by proper documentation and details and should be available to substantiate related account balances.

Condition: No subsequent collections have been received for the following receivables. Moreover, the details and supporting documents for these receivables were not available for review.

<u>Account</u>	<u>Account Name</u>	<u>Description</u>	<u>Amount</u>
250	A/R General	Receivable By Yap Trust Fund Fy2003	\$205,262
		Bank Of Fsm-Bank Error	27,645
		Bank Of Guam-Bank Error	17,019
		Emb. Of Washington Dc/Imprest	10,499
		FY 86-99 Receivable	79,555
257	A/R Miscellaneous	Prior To Fy1999 Balance	29,447
		Fy02 Kosrae Trust Fund Closing	28,958
258	A/R Chuuk Trust	Prior To Fy1999 Balance	106,292
		Fy02 Chuuk Trust Fund Receivable	<u>267,291</u>
	Total		<u>\$771,968</u>

Cause: Portions of the above may not represent valid receivables. The receivables from trust funds were actually cash reconciling items, which were recorded as a result of an attempt to reconcile related cash accounts. Since it was not possible to determine the nature of the reconciling items, an entry was proposed to defer recording expenditures. Instead, this unknown amount was recorded as a receivable.

For other receivables, documents may have been misplaced due to the age of these receivable.

Effect: This condition results in an overstatement of receivables and an understatement of expenditures.

Recommendation: For those receivables arising from trust funds, the National government should identify the adjustments to properly record these as expenditures in the appropriate organization or should write these balances off. The other balances should either be collected or be written off.

Auditee Response and Corrective Action Plan: We agree with this finding.

The \$79,555 in account 250 was written off in FY05, the \$29,447 and \$28,958 in account 257 were also written off in FY05, while \$106,292 and \$267,291 in account 258 were likewise written off in FY05.

The Bank Reconciliation Manager will reconcile the amounts reflected in the Bank of FSM, Bank of Guam and Washington DC account.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-32 – Collection Effort on Bank Errors

Criteria: Bank errors should be timely resolved, and collection efforts should be documented in writing and be readily available for review.

Condition: Receivables from certain banks are recorded in the amount of \$44,664 based on represented bank errors. It is the entity's representation that inquiry and collection efforts have been made for these balances. However no documentation was provided for our review to substantiate the entity's collection effort. Furthermore, a portion of these balances arose in prior years.

Cause: The cause could be due to either of the following:

- Improper recordkeeping of documents
- Collection efforts if any, was not documented in writing and as such, no documents can be provided

Effect: We could not determine the validity of these receivables.

Recommendation: We recommend that collection efforts relative to those items that are represented to be bank errors be properly documented.

Auditee Response and Corrective Action Plan: We agree with this finding.

The Bank Reconciliation Manager will reconcile the amounts reflected in the Bank of FSM, Bank of Guam and Washington DC account.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-33 – Untimely Liquidation of Representation Advances

Criteria: Section 224A of title 55 of the Code of the FSM, states in part regarding advance payment of representation, "...the recipient of such advance payment agrees to submit affidavits or receipts for actual expenditures and return to the Secretary of Finance all amounts advanced but not accounted for by affidavit, contract or receipt no later than one month after the end of the fiscal year." With this, it follows that the advance representation should be liquidated within one month of the end of the fiscal year so such advance should be included as an expenditure of that fiscal year.

Condition: A receivable for outstanding advance representation existed at September 30, 2004, in the amount of \$204,594 as follows:

<u>Account</u>	<u>Year</u>	<u>Amount</u>
263	2003 and prior	\$135,736
263	2004	\$68,858

Cause: This condition appears to be due to untimely liquidation of the advances.

Effect: This condition results in an understatement of expenditures and an overstatement of receivables.

Recommendation: Representation advances should be timely liquidated and be recorded as expenditures in the year the advance is made.

Auditee Response and Corrective Action Plan: We agree with this finding.

The General Operations Manager will look into this matter and will be instructed to clear all representation advance in FY06.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-34 – Unsupported Encumbrances

Criteria: Adequate source documentation should be available to support amounts and items encumbered.

Condition: For 44 of 119 (37%) items tested, encumbrances were not supported by underlying documentation such as purchase orders and contracts.

Cause: The root cause of the weakness is a lack of control over recordkeeping.

Effect: The effect of this condition is a potential misstatement of encumbrances.

Recommendation: We recommend that the Government exercise more stringent document policies to prevent the disappearance of necessary encumbrance support.

Auditee Response and Corrective Action Plan: We agree with this finding.

The certification accountants have been instructed to be more vigilant in keeping the documents for the encumbrances.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-35– Unsupported expenditures

Criteria: Adequate source documentation must be available to support amounts and items reported.

Condition: For 77 of 134 (57%) non-federal expenditures tested, underlying documentation, such as vendor's invoices, allotment advices, contracts, etc. were not on file.

Cause: The root cause of the weakness is a lack of control over recordkeeping.

Effect: The effect of this condition is a potential misstatement of expenditures.

Recommendation: We recommend that the FSM National Government exercise more stringent document policies to prevent the disappearance of necessary supporting documentation.

Auditee Response and Corrective Action Plan: We agree to the eight unsupported expenditures that relates to the FSM Embassy Washington D.C., however, we do not agree to the sixty nine expenditures that relates to the expenditures for COM, payroll, travel and representation. The check files, and other documents they requested were provided to the auditors and were reviewed but they claim that they cannot clear these findings as we provided them late or after the cut off date of their audit.

Auditor Response: The auditors did not review the documentation specified in the response as those documents were not provided by July 7, 2006. Additionally, there is no indication that all the missing documents have been located.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-36 – Encumbrance Aging

Criteria: Encumbrances should be aged and cancelled, accordingly.

Condition: Based on the following encumbrance analysis, various encumbrances are dated and may require cancellation.

<u>Year</u>	<u>Contract -C</u>	<u>Job Order - J</u>	<u>Local PO - L</u>	<u>Misc - M</u>	<u>Off Island PO</u>	<u>Total</u>
1999	\$332,552	5,740	-	-	250,602	\$ 588,895
2000	232,315	1,625	-	-	92,741	326,681
2001	48,072	8,995	-	-	238,038	295,105
2002	145,295	3,872	20,165	-	150,569	319,903
2003	235,404	15,000	30,140	30,000	524,944	835,488
2004	<u>997,484</u>	<u>78,704</u>	<u>864,194</u>	<u>27,615</u>	<u>784,976</u>	<u>2,752,973</u>
	<u>\$1,991,125</u>	<u>113,936</u>	<u>914,499</u>	<u>57,615</u>	<u>2,041,870</u>	<u>\$5,119,045</u>

Cause: There appears to be a lack of periodic review of aged encumbrances.

Effect: Encumbrances may include purchase orders/contracts that should be cancelled.

Recommendation: On a periodic basis, responsible personnel should review schedules of aged encumbrances and should effect cancellations, if necessary.

Auditee Response and Corrective Action Plan: We agree with this finding. The certification accountants and the general manager will look into these matter and effect cancellations to clear encumbrances that are no longer valid.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-37 – Unreimbursed Federal Expenditures

Criteria: A functioning system of internal control requires that details of unreimbursed expenditures payable to State Governments be reconciled on a periodic basis.

Condition: Intergovernmental payables to State Governments for unreimbursed federal grant expenditures were lower than related subrecipient balances as of September 30, 2004.

<u>States</u>	<u>Balance</u>
Kosrae	\$ 1,950,776
Chuuk	1,069,409
Pohnpei	1,821,715
Yap	<u>1,136,971</u>
Total	\$ <u>5,631,424</u>
FSM National government	\$ <u>1,349,890</u>
Difference	\$ <u>4,281,534</u>

Cause: The cause of this condition is the lack of high level review of account balances by management and the absence of reconciliations with the States.

Effect: The effect of this condition is a qualification of the opinion on the financial statements.

Prior Year Status: Untimely reconciliation of intergovernmental payables was reported as a finding in the Single Audit of the PFSM National Government for fiscal year 2003.

Recommendation: We recommend that the FSM National Government ensure that intergovernmental payables are properly reconciled.

Auditee Response and Corrective Action Plan: This finding has been reported since FY2001. We agree that governmental accounts should be properly reconciled. In 2005, as part of the process of reconciling intergovernmental account balances, a letter was issued to each state asking for details in their books of amounts owe them from the national Government to ascertain whether the amounts agreed with those on the books of the national Government.

Discussions have taken place in February 2006 with the representatives of Pohnpei State to reconcile intergovernmental balances. Significant progress has been made in identifying intergovernmental differences. Similar discussions will take place with the other three states in 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-38 – Unreimbursed CFSM Projects

Criteria: A functioning system of internal control requires that details of unreimbursed expenditures payable to the State Governments be reconciled on a periodic basis.

Condition: Intergovernmental payables to State Governments for unreimbursed Congress of the Federated States of Micronesia (CFSM) project expenditures were lower than the total subrecipient balances as of September 30, 2004.

<u>States</u>	<u>Balance</u>
Kosrae	\$ 469,409
Chuuk	70,503
Pohnpei	61,574
Yap	<u>33,793</u>
Total	\$ <u>635,279</u>
FSM National government	\$ <u>1,418,138</u>
Difference	\$ <u>782,859</u>

Cause: The cause of this condition is the lack of high level review of account balances by management and the absence of reconciliations with the States.

Effect: The effect of this condition is a qualification of the opinion on the financial statements.

Prior Year Status: Untimely reconciliation of intergovernmental payables was reported as a finding in the Single Audit of the FSM National Government for fiscal year 2003.

Recommendation: We recommend that intergovernmental payables be properly reconciled.

Auditee Response and Corrective Action Plan: This finding has been reported since FY2001. We agree that governmental accounts should be properly reconciled. In 2005, as part of the process of reconciling intergovernmental account balances, a letter was issued to each state asking for details in their books of amounts due to/from the National Government to ascertain whether the amounts agreed with those on the books of the National Government.

Discussions have taken place in February 2006 with the representatives of Pohnpei State to reconcile intergovernmental balances. Significant progress has been made in identifying intergovernmental differences. Similar discussions will take place with the other three states in 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No. 2004-39 – Liability Reconciliation

Criteria: Analysis of significant general ledger balances should be performed on a regular basis.

Condition: Preparation of detailed supporting schedules, and/or reconciliation to supporting subsidiary ledgers, was not performed for the following general ledger accounts.

<u>Account Name</u>	<u>Account No.</u>	<u>Balance</u>
Accrued Liabilities:		
General Fund:		
MMA Fishing	10-535	\$ 279,500
Other Payable	11-802	<u>27,690</u>
		\$ <u>961,229</u>
Special Revenue Fund:		
Retained Earnings	52-569	\$ <u>1,652</u>
Expendable Trust Fund:		
Notes Payable	83-506	\$ <u>50,575</u>

Cause: The cause of this condition is the lack of high level review of account balances by management.

Effect: The effect of this condition is a potential overstatement of liabilities as these accounts appears to be invalid.

Recommendation: Management should establish policies and procedures requiring responsible personnel to analyze all general ledger accounts at month-end. Such policies and procedures should include performing roll forwards of balances, indicating beginning balances, transaction detail for the period, and ending balances. Additionally, reconciliation of all subsidiary ledgers to the general ledger should be performed. Finally, high-level reviews of balances should be performed by knowledgeable individuals to determine the reasonableness of such balances.

Auditee Response and Corrective Action Plan: We agree with this finding together with the recommendation from the auditor. We will address this finding in FY06.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2004-01  
 CFDA #: 15.875  
 Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Grant Program Name: Compact of Free Association Economic, Social and Political Development  
 of the Territories and the Freely Associated States Sector Grants  
 Requirement: Allowable Costs/Cost Principles and Procurement  
 Questioned Costs: \$2,607,204

Criteria: In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for the program needs and appears to be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 33 of 41 (80%) non-payroll expenditures tested (\$2,607,204 out of the aggregate amount of \$2,734,837 tested), either partial or no financial and/or programmatic records (canceled checks, invoices, receiving reports, etc.) were on file to substantiate the following transactions. Additionally, for almost all transactions listed below, there was insufficient documentation in support of competitive procurement activities.

<u>Fund No</u>	<u>Acct</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Costs</u>
721411	8302	INSTRUCTIONAL HRS BY 515 TCHER	1/19/2004	JV724004	\$ 614,061
721421	8302	INSTRUCTIONAL HRS BY 189 TCHER	1/19/2004	JV724005	300,001
731201	8302	ADEQUATE MEDICAL SUPPLIES	1/18/2004	73JA001	223,115
721765	8302	ELIGILBE APPLICANTS DETERMINED	1/18/2004	JV724001	150,000
721411	8302	QTRLY RPT DATA&INFORMATION-4	1/19/2004	JV724004	139,784
731206	8302	INPATIENTS CARE	1/18/2004	73JA007	135,458
741624	8302	INVESTIGATION& PREVENTIVE PROG	1/19/2004	JVA74005	127,243
731201	8307	ADEQUATE MEDICAL SUPPLIES	9/3/2004	400758701	109,619
731201	8307	ADEQUATE MEDICAL SUPPLIES	6/11/2004	400481201	97,684
731205	8302	PATIENTS ENCOUNTERED-23302	1/18/2004	73JA006	83,157
721411	8302	QTRLY RPT DATA&INFORMATION-4	1/19/2004	JV724004	80,900
721411	8302	STDNTS FOR EDUCAITONAL SUPPRT	1/19/2004	JV724004	60,216
741951	8302	ACCURACY OF NOTARY/BIRTH CERTI	3/31/2004	JVA74027	57,733
721421	8302	MEAL SERVICES-886,922	1/19/2004	JV724005	54,402
741951	8302	ACCURACY OF NOTARY/BIRTH CERTI	1/19/2004	JVA74006	47,717
731221	8302	PATIENTS ENCOUNTERED-20,800	1/18/2004	73JA003	40,063
741051	8302	MONITORING & IMPLEMENTING OF P	1/19/2004	JVA74000	30,827
731201	8210	ADEQUATE MEDICAL SUPPLIES	4/22/2004	400404201	27,500
751533	8302	PERIODIC SURVEILLANCE, 300 PAT	1/18/2004	75JA018	27,238
721421	8302	BOARDING PROGRAM FOR 1,500	1/19/2004	JV724005	24,082
731201	8314	ADEQUATE MEDICAL SUPPLIES	3/10/2004	73JV037	21,834
741105	8302	TRAVEL AUTHORIZATIONS & PMT VO	1/19/2004	JVA74004	21,303
741625	8302	FIRE SAFETY	1/19/2004	JVA74005	20,260
761532	8302	PRODUCE 75 TON ICE PER WEEK	1/19/2004	JVA76008	17,510
761152	8302	PROPERTY CERTIFY THESE OWNERSH	1/19/2004	JVA76010	15,355
721421	8312	MEAL SERVICES-886,922	9/30/2004	400749501	14,409
721421	8312	MEAL SERVICES-886,922	2/19/2004	400136701	11,570

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-01, Continued  
 CFDA #: 15.875  
 Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Grant Program Name: Compact of Free Association Economic, Social and Political Development  
 of the Territories and the Freely Associated States Sector Grants  
 Requirement: Allowable Costs/Cost Principles and Procurement  
 Questioned Costs: \$2,607,204

Condition, Continued:

<u>Fund No</u>	<u>Acct</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Costs</u>
731201	8314	ADEQUATE MEDICAL SUPPLIES	5/18/2004	400438301	11,000
761152	8302	TO IMPROVED CADASTERAL PROGRAM	1/19/2004	JVA76010	10,733
731201	8314	ADEQUATE MEDICAL SUPPLIES	8/19/2004	400386913	9,780
731201	8314	ADEQUATE MEDICAL SUPPLIES	6/17/2004	400489001	9,000
731201	8442	PATIENTS SUPPORTED IN HAWAII	5/31/2004	73JA0111	7,000
731201	8311	PATIENTS SUPPORTED IN HAWAII	9/3/2004	400572904	6,650
					\$ <u>2,607,204</u>

Cause: There appears to be a lack of controls over record keeping and ensuring that program expenditures are substantiated by such documents as cancelled checks, invoices, receiving reports, etc.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles and procurement requirements.

Recommendation: The Chuuk State Government should comply with applicable allowable costs/cost principles and procurement requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We acknowledge that there are deficiencies in the filing system in Chuuk State that complicate document retrieval for audit review. We note, however that the above expenditures were approved by the Chuuk Financial Control Commission prior to payment and are authorized program expenditures for the appropriate sector grant. Many of the expenditures noted represent journal voucher transfers wherein expenditures first recorded in the general fund, because of late allotment of the 04 Compact sector grants, were later transferred to the appropriate compact sector fund; complete documentation supporting the transfers and the original recording in the general fund was often not attached to the journal vouchers. Chuuk State finance has implemented changes to its filing procedures that will more readily facilitate substantiating program expenditures. These changes will be effective for the fiscal year 2006 audit in November, 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-02  
CFDA #: 15.875  
Agency: U.S. Department of the Interior, Office of Insular Affairs  
Grant Program Name: Compact of Free Association Economic, Social and Political Development  
of the Territories and the Freely Associated States Sector Grants  
Requirement: Allowable Costs/Cost Principles  
Questioned Costs: Undeterminable

Criteria: In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for the program needs and in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 69 of 70 samples (99%) tested, personnel action forms, time sheets, journal vouchers and pay registers were not provided.

Cause: There appears to be a lack of controls exercised over record keeping, rate amendment and check disbursement policies in serving the objective of the program.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles requirements.. Because Personnel Action Forms are not on file, amounts are undeterminable since we do not know the effective dates of employment and the effective employee pay rates.

Recommendation: The Chuuk State Government should comply with applicable allowable costs/cost principles requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation but acknowledge that all employees were appropriately charged to the correct sector grant.. In fiscal year 2004, personnel expenditures were initially charged to the general fund, and after the sector grant allotments arrived, were subsequently transferred to the sector funds. Only 90% of the expenditures, however, were transferred leaving 10% in the general fund. Because the journal voucher supporting this transfer was done in total and not by individual employee, it was not possible to substantiate the exact amount transferred on an individual employee basis; consequently, the citation for lack of support. Finance management will make improvements to the filing of personnel records to better substantiate relevant expenditures for individual employees. This will be done before the commencement of the FY-06 audit in November, 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-03  
 CFDA #: 83.544/97.036  
 Agency: U.S. Department of Homeland Security  
 Program Name: Public Assistance Grants  
 Requirement: Allowable Costs/Cost Principles and Procurement  
 Questioned Costs: \$719,496

**Criteria:** In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for program needs and should be executed in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

**Condition:** For 18 of 18 (100%) non-payroll expenditures tested (\$719,496 of the aggregate amount of \$719,496 tested), either partial or no financial and/or programmatic records (canceled checks, invoices, receiving reports, etc.) were on file to substantiate the following transactions. Additionally, for almost all transactions listed below, there was insufficient documentation in support of competitive procurement activities.

<u>Fund No</u>	<u>Fund Description</u>	<u>Acct</u>	<u>Vendor #</u>	<u>APV#</u>	<u>Check #</u>	<u>Questioned Costs</u>
301036	FEMA 1427-DR-FM (CHAATAN)	8405	4,133	300441101	70866	\$ 219,848
301037	FEMA	8405	3,302	400104801	72963	110,000
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400347501	73694	51,221
301037	FEMA	8302	3,075	400727401	76214	46,550
301036	FEMA 1427-DR-FM (CHAATAN)	8405	2,471	400069901	66137	40,000
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400559601	73694	37,016
301037	FEMA	8302	3,075	400727402	76214	32,339
301036	FEMA 1427-DR-FM (CHAATAN)	8405	31,194	400020501	65089	27,315
301037	FEMA	8302	4,133	400139301	71110	24,540
301037	FEMA	8405	3,302	400559501	73694	23,606
301036	FEMA 1427-DR-FM (CHAATAN)	8405	4,133	400104701	71110	18,860
301036	FEMA 1427-DR-FM (CHAATAN)	8405	31,194	400020401	65081	17,937
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,451	400022601	65147	16,709
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,451	400022301	65134	12,731
301037	FEMA	8302	3,075	400727404	76214	11,600
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400430801	73192	10,361
301036	FEMA 1427-DR-FM (CHAATAN)	8302	3,302	400761701	77223	9,532
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400347301	73694	9,331
					Total	\$ <u>719,496</u>

**Cause:** There appears to be a lack of controls over record keeping and ensuring that expenditure documentation demonstrates compliance with program objectives.

**Effect:** Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles and procurement requirements, and questioned costs result.

**Recommendation:** Chuuk State Government should comply with applicable allowable costs/cost principles and procurement requirements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-03, Continued  
CFDA #: 83.544/97.036  
Agency: U.S. Department of Homeland Security  
Program Name: Public Assistance Grants  
Requirement: Allowable Costs/Cost Principles and Procurement  
Questioned Costs: \$719,496

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. In fiscal year 2004, FEMA expenditures were made by the FSM National Government (FSMNG) through the local FSM finance office, using Chuuk State Compact CIP funds. Chuuk State does not have the documentation on file to support most of these expenditures, in particular the cancelled checks. Chuuk State will clear this finding in conjunction with the FSMNG. We are assured based on the documentation available that all these expenditures are in compliance with program objectives. Chuuk State Finance will clear these questioned costs with the FSMNG no later than December 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-04  
 CFDA #: 83.544/97.036  
 Agency: U.S. Department of Homeland Security  
 Program Name: Public Assistance Grants  
 Requirement: Period of Availability  
 Questioned Costs: Undeterminable

**Criteria:** In accordance with applicable period of availability requirements, expenditures should be recorded during the fund's period of availability.

**Condition:** Per review of detailed expenditures, we were unable to determine if the following expenditures were recorded outside the period of availability due to the absence of project worksheets.

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8310	2/1/2005		400802501	3064	\$ 2,698
8310	2/1/2005		400802601	3064	7,112
8310	2/1/2005		400802701	3064	1,900
8310	2/1/2005		400802801	3064	698
8310	2/1/2005		400802901	3064	698
8310	2/1/2005		400803001	3064	2,427
8310	2/1/2005		400803101	3064	309
8405	12/29/2004	L4171201	400765401	26445	42
8405	12/29/2004	L4171201	400765501	26448	42
8405	12/29/2004	L4171201	400765601	26449	42
8405	12/29/2004	L4171201	400765701	26450	42
8405	12/29/2004	L4171201	400765801	26451	42
8405	12/29/2004	L4171201	400765901	26455	42
8405	12/29/2004	L4171201	400766001	26456	42
8405	12/29/2004	L4167801	400766101	26457	26
8405	12/29/2004	L4167801	400766201	26455	26
8405	12/29/2004	L4167801	400766301	26456	26
8405	12/29/2004	L4167801	400766401	26013	26
8405	12/29/2004	L4174401	400766501	26013	117
8405	12/29/2004	L4174401	400766601	26458	100
8405	12/29/2004	L4174401	400766701	26459	100
8405	12/29/2004	L4174401	400766801	26460	100
8405	12/29/2004	L4169801	400766901	26456	58
8405	12/29/2004	L4169801	400767001	26013	58
8405	12/29/2004	L4169801	400767101	26009	58
8405	12/29/2004	L4169801	400767201	26458	58
8405	12/29/2004	L4169801	400767301	26457	58
8405	12/29/2004	L4172701	400767501	26135	100
8405	12/29/2004	L4172701	400767601	26461	100
8405	12/29/2004	L4172701	400767701	26462	100
8405	12/29/2004	L4172701	400767801	26463	100

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-04, Continued  
 CFDA #: 83.544/97.036  
 Agency: U.S. Department of Homeland Security  
 Program Name: Public Assistance Grants  
 Requirement: Period of Availability  
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	12/29/2004	L4172701	400767901	26464	\$ 100
8405	12/29/2004	L4172701	400768001	26465	100
8405	12/29/2004	L4172701	400768101	26466	100
8405	12/29/2004	L4170201	400768301	18875	56
8405	12/29/2004	L4170201	400768401	26464	56
8405	12/29/2004	L4174701	400768501	30901	130
8405	12/29/2004	L4174701	400768601	27540	111
8405	12/29/2004	L4174701	400768701	26467	111
8405	12/29/2004	L4174701	400768801	26468	111
8405	12/29/2004	L4174701	400768901	26469	111
8405	12/29/2004	L4174701	400769001	26470	111
8405	12/29/2004	L4174701	400769101	26471	111
8405	12/29/2004	L4174701	400769201	22468	130
8405	12/29/2004	L4174701	400769401	26472	111
8405	12/29/2004	L4174701	400769501	26473	111
8405	12/29/2004	L4173801	400769601	32112	50
8405	12/29/2004	L4173801	400769701	26475	40
8405	12/29/2004	L4173801	400769801	26476	40
8405	12/29/2004	L4172401	400780101	26478	50
8405	12/29/2004	L4172401	400780201	16427	50
8405	12/29/2004	L4169201	400780301	23512	100
8405	12/29/2004	L4169201	400780401	26479	80
8405	12/29/2004	L4169201	400780501	26480	80
8405	1/5/2005	L4173001	400763101	35265	45
8405	1/5/2005	L4173001	400763201	35266	45
8405	1/5/2005	L4173001	400763301	35267	45
8405	1/5/2005	L4170401	400780601	4377	124
8405	1/5/2005	L4170401	400780701	16427	100
8405	1/5/2005	L4170401	400780801	26481	100
8405	1/5/2005	L4170401	400780901	35268	100
8405	1/5/2005	L4185801	400781001	32094	110
8405	1/5/2005	L4185801	400781101	8131	110
8405	1/5/2005	L4185801	400781201	11974	110
8405	1/5/2005	L4185801	400781301	27011	110
8405	1/5/2005	L4157501	400781601	35286	150

**FEDERATED STATES OF MICRONESIA  
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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-04, Continued  
 CFDA #: 83.544/97.036  
 Agency: U.S. Department of Homeland Security  
 Program Name: Public Assistance Grants  
 Requirement: Period of Availability  
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	1/5/2005	L4157501	400781701	35287	\$ 150
8405	1/5/2005	L4157501	400781801	35288	150
8405	1/5/2005	L4157501	400781901	35289	150
8405	1/5/2005	L4157501	400782001	35290	150
8405	1/5/2005	L4157501	400782101	35291	150
8405	1/5/2005	L4157501	400782201	35292	150
8405	1/5/2005	L4157501	400782301	35293	150
8405	1/5/2005	L4157501	400782401	35294	150
8405	1/5/2005	L4157501	400782501	35295	150
8405	1/5/2005	L4146301	400782701	12751	100
8405	1/5/2005	L4146301	400782801	27004	100
8405	1/5/2005	L4146301	400782901	27005	100
8405	1/5/2005	L4146301	400783001	27006	100
8405	1/5/2005	L4146301	400783101	27007	100
8405	1/5/2005	L4146301	400783201	27008	100
8405	1/5/2005	L4146301	400783301	27009	100
8405	1/5/2005	L4146301	400783401	27010	100
8405	1/5/2005	L4146301	400783501	16138	100
8405	1/5/2005	L4173401	400790801	35276	100
8405	1/5/2005	L4173401	400790901	35277	92
8405	1/5/2005	L4173401	400791001	35278	92
8405	1/5/2005	L4173401	400791101	35279	92
8405	1/5/2005	L4173401	400791201	35280	92
8405	1/5/2005	L4173401	400791301	35281	92
8405	1/5/2005	L4173401	400791401	35282	92
8405	1/5/2005	L4173401	400791501	35283	92
8405	1/5/2005	L4173401	400791601	35284	92
8405	1/5/2005	L4173401	400791701	35285	92
8405	1/5/2005	L4171601	400794601	35252	90
8405	1/5/2005	L4171601	400794701	35253	90
8405	1/5/2005	L4171601	400794801	35254	90
8405	1/5/2005	L4171601	400794901	35255	90
8405	1/5/2005	L4171601	400795001	35256	90
8405	1/5/2005	L4171601	400795101	35257	90
8405	1/5/2005	L4171601	400795201	35258	90



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-04, Continued  
 CFDA #: 83.544/97.036  
 Agency: U.S. Department of Homeland Security  
 Program Name: Public Assistance Grants  
 Requirement: Period of Availability  
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	1/5/2005	L4171601	400795301	35259	\$ 90
8405	1/5/2005	L4171601	400795401	35260	90
8405	1/5/2005	L4183901	400795501	27016	148
8405	1/5/2005	L4183901	400795601	9372	148
8405	1/5/2005	L4183901	400795701	27017	148
8405	1/5/2005	L4183901	400795801	24649	148
8405	1/5/2005	L4183901	400795901	27018	148
8405	1/5/2005	L4184601	400796001	32102	100
8405	1/5/2005	L4184601	400796101	27013	100
8405	1/5/2005	L4184601	400796201	27014	100
8405	1/5/2005	L4184601	400796301	27015	100
8405	1/5/2005	L4184601	400796401	9972	100
8405	1/5/2005	L4186301	400796501	32092	75
8405	1/5/2005	L4186301	400796601	26927	30
8405	1/5/2005	L4158801	400796901	35248	90
8405	1/5/2005	L4158801	400797001	35249	90
8405	1/5/2005	L4158801	400797101	35250	90
8405	1/5/2005	L4158801	400797201	35251	90
8405	1/5/2005	L4158401	400797401	35272	30
8405	1/5/2005	L4158401	400797501	35273	30
8405	1/5/2005	L4158401	400797601	35274	30
8405	1/5/2005	L4158401	400797701	35275	30
8405	1/5/2005	L4167701	400797801	35269	182
8405	1/5/2005	L4167701	400797901	35270	100
8405	1/5/2005	L4167701	400798001	35271	100
8405	1/5/2005	L4147201	400798101	35261	77
8405	1/5/2005	L4147201	400798201	35262	50
8405	1/5/2005	L4147201	400798301	35263	50
8405	1/5/2005	L4147201	400798401	35264	50
8405	2/7/2005	L4175101	400804801	32109	438
8405	2/7/2005	L4175101	400804901	32108	250
8405	2/7/2005	L4175101	400805001	35292	250
8405	2/7/2005	L4175101	400805101	28946	250
8405	2/7/2005	L4175101	400805201	4377	250
8405	2/7/2005	L4175101	400805301	26133	250

**FEDERATED STATES OF MICRONESIA  
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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-04, Continued  
 CFDA #: 83.544/97.036  
 Agency: U.S. Department of Homeland Security  
 Program Name: Public Assistance Grants  
 Requirement: Period of Availability  
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	2/23/2005	L4186801	400806701	32060	\$ 53
8405	2/23/2005	L4186801	400806801	22145	53
8405	2/23/2005	L4186801	400806901	32090	<u>53</u>
Total					\$ <u>28,843</u>

Cause: There appears to be a lack of controls exercised over demonstrating that expenditures are used within the period of availability and over maintaining significant programmatic records on file.

Effect: Due to the absence of project work sheets, it is undeterminable if expenditures were expended in the period of availability; therefore, Chuuk State Government appears to be in potential noncompliance with period of availability requirements.

Recommendation: Chuuk State Government should maintain project worksheets in order to demonstrate compliance with applicable period of availability requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. As mentioned previously, the FSMNG handled Chuuk State FEMA expenditures and much of the documentation is with them and not with Chuuk State. We do not believe there is a problem with the period of availability because throughout fiscal years 2004 and 2005 program expenditures for typhoons Chaatan, Pongsana and related Hazard Mitigation programs were being approved by the FSM Disaster Office. Chuuk State Finance will clear these questioned costs with the FSMNG no later than December 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-05  
 CFDA #: 15.875  
 Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Grant Program Name: Compact of Free Association Section 211(a) Capital Account  
 Requirement: Allowable Costs/Cost Principles  
 Questioned Costs: \$726,976

**Criteria:** In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

**Condition:** For 48 of 73 (66%) non-payroll expenditures tested (\$726,976 of the aggregate amount of \$1,365,387 tested), either partial or no financial and/or programmatic records (canceled checks, invoice, receiving reports, etc.) were on file to substantiate the following transactions:

<u>Fund No</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Cots</u>
601802	TONOAS DISASTER RELIEF/RESTORA	9/30/2004	JV4M0001	\$ 190,921
601811	TOLENSOM MUN.FISHING/6-01-06M	9/30/2004	JV4M0003	66,276
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400091201	50,000
601051	CHUUK STATE HEALTH CARE PLAN	9/30/2004	JV4M0001	46,579
601813	FANAPANGES FISHING/6-02-11	2/12/2004	400120701	38,500
601051	CHUUK LEGISLATIVE BLDG/6-02-14	9/17/2004	400620901	30,000
601816	LOSAP FISHING PROJ/6-01-06M	2/10/2004	400117601	29,799
601051	CHUUK LEGISLATIVE BLDG/6-02-14	6/3/2004	400464601	24,000
601815	POLLE OFFICE SUPPLEMENTAL/02M	9/30/2004	JV4M0003	20,447
601809	UDOT SCHOOL REPAIR/6-01-06M	7/15/2004	400310001	15,000
601051	FY2003 STATE LAND LEASE & ACQ.	1/28/2004	400103401	15,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/3/2004	400110001	15,000
601803	FANIPW AGRICULTURAL/6-01-06M	9/30/2004	JV4M0002	15,000
601804	UMAN MUN.FISHING PROJ/6-02-11M	11/12/2003	400026801	14,750
601051	FY2003 STATE LAND LEASE & ACQ.	2/24/2004	400139701	12,000
601840	PIIS PANEU FISHING/6-01-06M	9/30/2004	JV4M0003	10,022
601810	ROMANUM ECON.FISHING/6-01-06M	9/30/2004	JV4M0002	10,000
601051	FY2003 STATE LAND LEASE & ACQ.	4/30/2004	400417201	10,000
601811	TOLENSOM MUN.OFFICE RENOV/03M	9/30/2004	JV4M0003	10,000
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400090901	8,600
601051	FY2003 STATE LAND LEASE & ACQ.	2/3/2004	400109701	8,500
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400091401	7,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/3/2004	400109801	7,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/6/2004	400114701	7,000
601803	UFO SEWING PROJ.FEFAN/6-01-06	9/30/2004	JV4M0001	6,999
601815	POLLE SAPOU MARKET/06-01-06M	9/30/2004	JV4M0004	6,175

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.: C2004-05, Continued  
 CFDA #: 15.875  
 Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Grant Program Name: Compact of Free Association Section 211(a) Capital Account  
 Requirement: Allowable Costs/Cost Principles  
 Questioned Costs: \$726,976

Condition, Continued:

<u>Fund No</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Cots</u>
601805	SIIS SEAWALL PROJ/6-01-06M	9/30/2004	JV4M0002	5,940
601803	INAKA FEFAN WATER/6-01-06M	9/30/2004	JV4M0002	5,781
601804	UMAN NEMERAI SAPOU FISHING/03	11/19/2003	400029101	5,160
601051	FY2003 STATE LAND LEASE & ACQ.	6/9/2004	400471901	5,000
601803	SANGKUMI FEFAN SEWING/06-01-06	9/30/2004	JV4M0002	4,000
601051	CHUUK STATE HEALTH CARE PLAN	9/30/2004	JV4M0004	3,930
601801	WENO NEPUKOS YOUTH CENTER/6-02	2/19/2004	400133201	3,475
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400090301	3,000
601803	FEFAN EL NINO/6-02-11M	3/19/2004	400269901	2,145
601801	KOKUMI WENO FISHING SOPUK/02M	9/30/2004	JV4M0004	2,000
601051	FY2003 STATE LAND LEASE & ACQ.	3/16/2004	400267001	2,000
601801	NEMWAN/MECHITIW PUB.TOILET/03M	10/15/2003	400003206	1,800
601804	UMAN MUN.FISHING PROJ/6-02-11M	7/14/2004	400550501	1,250
601051	FY2003 STATE LAND LEASE & ACQ.	1/27/2004	400101001	1,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/18/2004	400126401	1,000
601051	FY2003 STATE LAND LEASE & ACQ.	6/18/2004	400492701	1,000
601837	NOMWIN MULTI PURPOSE PUB.BLDG	9/30/2004	JV4M0003	1,000
601801	TUNNUK TOILET FACIL/6-02-11M	11/12/2003	400026403	974
601801	WENO WICHAP FISHING PROJECT	10/29/2003	400010301	700
601804	UMAN NEASAP COMM.CENTER/03M	11/10/2003	400012101	504
601804	UMAN NUKAN TEWENENO SEA WALL/03	10/29/2003	40008301	500
601803	FEFAN ROAD UPGRDE.SUPP/6-02-11	11/12/2003	400027405	250
			Total	<u>\$ 726,976</u>

Cause: There appears to be a lack of controls over record keeping and demonstrating program compliance with applicable allowable costs/cost principles requirements.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles requirements.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles requirements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Finding No.:	C2004-05, Continued
CFDA #:	15.875
Agency:	U.S. Department of the Interior, Office of Insular Affairs
Grant Program Name:	Compact of Free Association Section 211(a) Capital Account
Requirement:	Allowable Costs/Cost Principles
Questioned Costs:	\$726,976

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We note that old Compact CIP expenditures were being handled by the FSMNG through the local FSM revenue office throughout fiscal year 2004 and much of the documentation is not available in the Chuuk State Finance Office. During this period the Compact CIP funds were used for a variety of State and municipal purposes which we believe are within the program guidelines approved by OIA. Chuuk State finance will clear these questioned costs with the FSMNG no later than December, 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2004-01  
CFDA No.: 15.875  
Grant: Section 211 Education Sector, Health Sector, Capacity Building Sector Grants  
Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
Area: Allowable Costs/Cost Principles and Procurement  
Questioned Costs: \$38,373

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with the program. Also, sufficient records should be maintained to detail the significant history of procurement, including a rationale for vendor selection. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For one of 12 (8%) expenditures tested (\$8,550 out of the aggregate population of \$103,238), there were no procurement documents on file or no justification of the procurement selection.

Check No	Payee	APV #	APV Amt	Fund	Org	Cost Center
10530	Bank of the Fsm	400376450	\$25,767	73	1211	KA220A

For two of 12 (17%) expenditures tested (\$18,006 out of the aggregate population of \$103,238), there was no invoice on file.

Check No	Payee	APV #	APV Amt	Fund	Org	Cost Center
9901	Kosrae Utility Authority	400326501	\$ 6,654	72	1410	KA100A
10380	Kosrae Utility Authority	400391201	5,952	72	1410	KA100A
<b>TOTAL</b>			<b>\$12,606</b>			

Cause: There appears to be a lack of internal controls over ensuring compliance with the applicable allowable costs/cost principles and procurement requirements, and questioned costs result.

Effect: The Kosrae State Government appears to be in noncompliance with thee applicable allowable costs/cost principles and procurement requirements, and questioned costs result.

Recommendation: The Kosrae State Government should comply with Compact II grant requirements.

Auditee Response and Corrective Action Plan: We agree with the findings, the Kosrae State Government will comply with the recommendation.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2004-02  
 CFDA No.: 15.875  
 Grant: Section 211 Education Sector, Health Sector, Capacity Building Sector Grants  
 Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Area: Period of Availability  
 Questioned Costs: \$80,202

Criteria: Expenditures should be recorded in the appropriate period.

Condition: For ten of 12 (83%) expenditures tested (\$101,358 out of the aggregate population of \$103,238), the underlying receipt of goods or services occurred in fiscal year 2003 or earlier but these costs were charged to the fiscal year 2004 grant awards.

Check No	Payee	APV #	APV Amt	Fund	Org	Cost Center
11778	KOSRAE UTILITY AUTHORITY	400550501	\$ 13,364	72	1410	KA100A
9901	KOSRAE UTILITY AUTHORITY	400326501	6,654	72	1410	KA100A
10380	KOSRAE UTILITY AUTHORITY	400391201	5,952	72	1410	KA100A
10380	KOSRAE UTILITY AUTHORITY	400391101	15,000	73	1410	KA100A
10937	KOSRAE UTILITY AUTHORITY	400445701	15,000	73	1213	KA200B
11420	KOSRAE UTILITY AUTHORITY	400498601	2,838	74	1610	KA435A
11618	COM-FSM NATIONAL CAMPUS	400528401	20,000	76	1102	KA631H
11746	COM-FSM NATIONAL CAMPUS	400528502	14,000	76	1102	KA631H
		<b>Subtotal</b>	<b>92,808</b>			
<b>LESS: Amounts previously Questioned in 2004-01</b>						
9901	KOSRAE UTILITY AUTHORITY	400326501	(6,654)	72	1410	KA100A
10380	KOSRAE UTILITY AUTHORITY	400391201	(5,952)	72	1410	KA100A
		<b>TOTAL</b>	<b>\$ 80,202</b>			

Cause: There appears to be a control deficiency over ensuring that expenditures are recorded in the appropriate period.

Effect: Expenditures may be misstated in both FY 2003 and FY 2004, and the Kosrae State Government appears to be in noncompliance with the program requirements, and questioned costs result.

Recommendation: The Kosrae State Government should ensure that expenditures are correctly accounted for in relation to the fiscal year they relate and should comply with Compact II requirements.

Auditee Response and Corrective Action Plan: We agree with the finding that the expenditures were not recorded in the proper period.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2004-03  
CFDA No.: 15.875  
Grant: Section 211 Infrastructure Sector Grant  
Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
Area: Reporting  
Questioned Costs: \$0

Criteria: Financial Status Reports (FSRs) should be accurate and submitted in accordance with grant terms and conditions.

Condition: The FSR for Compact Infrastructure Sector Fund 68 was not submitted. Furthermore, FSR expenditures reported were less than detailed expenditures recorded for the fiscal year.

Cause: There appears to be a lack of internal controls over the preparation and accuracy of federal financial reports.

Effect: The Kosrae State Government appears to be in noncompliance with reporting requirements.

Recommendation: The Kosrae State Government should comply with the Compact Sector Grant requirements.

Auditee Response and Corrective Action Plan: Kosrae State Government did not receive any fund for Compact II Sector Fund 68 which is the infrastructure Sector. The Audit condition has been corrected. The Administrator of Division of Finance & Budget will be responsible for compliance.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2004-04  
 CFDA No.: 15.875  
 Grant: Section 211 Health Sector, Capacity Building Sector and Private Sector Grants  
 Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
 Area: Allowable Costs/Cost Principles  
 Questioned Costs: \$9,034

**Criteria:** Expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

**Condition:** For 2 of 34 (6%) items tested, there was no timesheet on file to verify hours.

FUND	Check #	PP#	PPE	Empl #	Gross Pay	Deduction	Net Pay
73	30790	13	6/12/2004	78406	\$2,304	\$428	\$1,876
76	29556	11		18526	<u>608</u>	\$577	\$ 31
					<u>\$2,912</u>		

For 4 of 34 (12%) items tested, there was no personnel action form on file to verify the applicable pay rate.

FUND	Check #	PP#	PPE	Empl #	Gross Pay	Deduction	Net Pay
73	32810	16	7/24/2004	29422	\$1,077	\$449	\$ 628
73	33513	17	8/07/2004	800610	2,015	\$ 250	\$1,764
73	34159	18	8/21/2004	33210	872	\$ 639	\$ 234
73	35531	20	9/18/2004	58250	<u>924</u>	\$ 571	\$ 353
					<u>\$4,888</u>		

For 3 of 34 (9%) items selected, employee timesheet hours were less than 80 hours and holiday hours were paid at double the regular rate.

FUND	Check #	PP#	PPE	Empl #	Gross Pay	Deduction	Net Pay
74	29482	11	05/15/04	24057	\$ 446	\$287	\$159
74	34256	18	08/21/04	43961	406	\$235	\$171
74	35612	20	09/18/04	29492	<u>382</u>	\$180	\$202
					<u>\$1,234</u>		

**Cause:** There appears to be a lack of controls exercised over record keeping and documentation to ensure that payroll transactions are substantiated by timesheets and personnel action forms and that expenditures meet program requirements.

**Effect:** The Kosrae State Government appears to be in noncompliance with the allowable costs/cost principles requirements. A questioned cost exists. Although the known questioned cost is less than \$10,000, the projected questioned cost exceeds the threshold.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2004-04, Continued  
CFDA No.: 15.875  
Grant: Section 211 Health Sector, Capacity Building Sector and Private Sector Grants  
Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
Area: Allowable Costs/Cost Principles  
Questioned Costs: \$9,034

Recommendation: The Kosrae State Government should ensure that all current Personnel Action Forms and timesheets are filed within individual employee files to substantiate expenditures.

Auditee Response and Corrective Action Plan: We agree to this finding. All employee files are being reviewed for proper wage documentation. Unsupported compensation will be reviewed with appropriate Department Director for obtaining of proper wage documentation. The Payroll Officer will substantiate wage rates with proper documentation prior to processing new payroll compensation. On a monthly basis, the Finance Administrator will spot check payroll records to insure compliance. The Payroll Officer will be responsible for procedural compliance.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2004-05  
CFDA No.: 84.027  
Grant: Special Education – Grants to States  
Grant No.: H027B030002-04  
Grantor Agency: U.S. Department of Education  
Area: Cash Management  
Questioned Costs: Undeterminable

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the clearing of the applicable check should be minimized.

Condition: The Kosrae State Government could not provide documented details of expenditure drawdowns per GAPS for the program.

Cause: There appears to be a lack of internal controls over cash management.

Effect: The Kosrae State Government appears to be in noncompliance with applicable cash management requirements. Due to lack of information available and provided by the grantee, the amount of questioned costs, if any, resulting from this condition is undeterminable.

Prior Year Status: The inability of the State to support cash management requirements was reported as a finding in the State's 2003 Single Audit report.

Recommendation: The Kosrae State Government should establish internal controls over cash management and should match applicable drawdowns with checks issued.

Auditee Response and Corrective Action Plan: Kosrae State Government (KSG) do agree with this finding. KSG has implemented in fiscal year 2006 internal control over cash management requirements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2004-06  
CFDA No.: 84.027  
Grant: Special Education – Grants to States  
Grant No.: H027B030002-04  
Grantor Agency: U.S. Department of Education  
Area: Allowable Costs/Cost Principles  
Questioned Costs: \$10,124

Criteria: Expenditures should meet program objectives.

Condition: For four of 12 (33%) transactions tested (\$35,268 out of the aggregate population tested of \$88,767), there was no information demonstrating the relevancy of the charges to the program.

Org #	Check No	Payee	APV #	APV Amt
301410	12230	F.S.M. TELECOMM. CORP.	400566005	\$ 2,974
301410	8916	F.S.M. TELECOMM. CORP.	400163902	2,664
301410	7822	F.S.M. TELECOMM. CORP.	400028706	2,317
301410	11943	F.S.M. TELECOMM. CORP.	400551901	<u>2,169</u>
			<b>TOTAL</b>	<b><u>\$10,124</u></b>

Cause: There appears to be a control deficiency over ensuring that expenditures meet program objectives.

Effect: Expenditures have been misstated, and the Kosrae State Government appears to be in noncompliance with the allowable costs/cost principles requirements, and questioned costs result.

Recommendation: The Kosrae State Government should ensure that expenses are correctly accounted for and comply with allowable costs/cost principles requirements.

Auditee Response and Corrective Action Plan: We agree to this finding. The Kosrae DOE Special Education will ensure that a logging system is in place and that expenses are correctly accounted for in relation to the fiscal year they relate to and comply with the condition specified in the criteria.

The charges are all relevant to the program as justified by program personnel. Please verify the questioned costs.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Pohnpei**

Finding No.: P2004-01  
CFDA No.: 15.875  
Agency: U.S. Department of the Interior, Office of Insular Affairs  
Grant #: Compact Sector Grants  
Program Name: Pohnpei State Government  
Requirement: Procurement and Suspension and Debarment  
Questioned Costs: \$30,000

**Criteria:**

In accordance with OMB Circular A-133 procurement requirements, procurements shall provide full and open competition among vendors, any allowable exceptions must be properly documented and approved in accordance with applicable Pohnpei State Government procurement requirements and such approvals should be documented in the procurement file. Also, per local law, the procurement officer shall obtain price quotations from at least three vendors for all small purchases over \$25,000 not put to bid, unless the entity documents that only two vendors possess the required goods or services.

**Condition:**

For two of 25 (8%) non-payroll samples selected, there were no procurement documents on file evidencing the procurement rationale.

<u>Acct</u>	<u>Date</u>	<u>Contract/ JV/TA #</u>	<u>APV #</u>	<u>Check #</u>	<u>Amount per APV</u>
8460	6/8/2004		810275	172953	\$ 30,000
8405	6/3/2004	C40035	809680	172686	<u>4,317</u>
					\$ <u>34,317</u>

**Cause:**

There appears to be weak controls over ensuring that competition remains open among vendors. However, if no more than two vendors possess required merchandise, no competitive procurement is required. In the above instances, no documentation was available that compliance with the Compact II regulations was met.

**Effect:**

The grantee appears to be in noncompliance with applicable Compact II procurement regulations.

Questioned costs of \$30,000 arise from this finding. No questioned costs result from the \$4,317 item as subsequently we verified that Pohnpei State credited this account and charged this amount against the State's general fund.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Pohnpei**

Finding No.:	P2004-01, Continued
CFDA No.:	15.875
Agency:	U.S. Department of the Interior, Office of Insular Affairs
Grant #:	Compact Sector Grants
Program Name:	Pohnpei State Government
Requirement:	Procurement and Suspension and Debarment
Questioned Costs:	\$30,000

**Recommendation:**

The Department should strengthen internal controls on procurement to maximize competition while maintaining the best interest of the department. If there are any exceptions allowed by procurement regulations, they should be reviewed, approved and properly documented in the procurement file.

**Auditee Response and Corrective Action Plan:**

The Department of Treasury and Administration has communicated to the grantor agency to resolve the questioned costs. We are still waiting for the reply from OIA.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: 2004-1  
CFDA No.: 97.036  
Grantor: U.S. Department of Homeland Security (FEMA) (DHS)  
Area: Procurement  
Questioned Costs: \$0

Criteria: Federal regulations state that all procurement transactions will be conducted in a manner providing for full and open competition. Grantees and subgrantees will use their own procurement procedures, which reflect applicable State and local laws and regulations providing that the procurements conform to applicable federal law.

Condition: Of \$435,736 in DHS non-payroll expenditures tested, we noted two disbursements for \$48,800 (APV#19434) and \$4,307 (APV#18284) pertaining to Disaster 1511 PW 309 for which bidding documents, quotes, or certification of calls made to evidence full and open competition were not provided.

Cause: Due to the nature of the emergency, there was a waiver of procurement procedures by the Governor, and any documentation of verbally acquired quotes was not maintained.

Effect: No questioned costs result from this matter after we verified the information provided in the auditee response.

Recommendation: Management should ensure that documentation is maintained and procurement regulations complied with at the point in time that procurements are initiated.

Auditee Response and Corrective Action Plan: The finding pertains to the repair of the roof at the Yap Memorial Hospital. At the time of Typhoon Sudal, Pacific Modair Corporation was already repairing the roof under another contract with YMH that had been competitively awarded. Public Works felt it in the public interest that Pacific Modair also repair the roof damages from Typhoon Sudal and requested a waiver from the bidding requirements in a May 24, 2004 letter to the Governor. The Governor approved the waiver on June 15, 2004 and a change order was added to the original contract to accommodate the temporary repairs necessitated by Typhoon Sudal.

Documentation is on file with the Yap Department of Public Works.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2004-2  
CFDA No.: 97.036  
Grantor: U.S. Department of Homeland Security (FEMA) (DHS)  
Area: Allowable Costs/Cost Principles  
Questioned Costs: \$0

Criteria: Allowable costs are for the approved project and scope of work indicated on project worksheets.

Condition: Of \$435,736 in DHA non-payroll expenditures tested, we noted a project overrun of \$54,085 for Disaster 1511 PW #34, and of \$24,350 in payroll expenditures tested, we noted a project overrun of \$4,466 for Disaster 1511 PW #444. As of our fieldwork date (over a year after overruns had occurred), approval from FEMA had not been obtained. Such was corrected through an entity adjustment that transferred overruns back to the General Fund.

Cause: The cause is the untimely reconciliation of records between the Public Assistance Office and the Office of Administrative Services as well as a delay in obtaining necessary approvals from the grantor.

Effect: The impact may be unbudgeted expenditures in the General Fund and the loss of grantor revenue.

Recommendation: Management should ensure that overruns are monitored and addressed on a timely basis.

Auditee Response and Corrective Action Plan: As noted in the finding condition, Yap State Finance adjusted the budget overruns on the two projects with corrective journal vouchers on September 30, 2004. The delay was the result of having first charged FEMA related expenditures to the general fund and waiting until after FY-05 to transfer the related charges to the FEMA grant fund. As a result, these two projects experienced overruns that had to be transferred back to the general fund. Because typhoon Sudal is still an open, FEMA may subsequently approve these additional expenditures but that determination could not be made at the date of the audit.

The Assistant Director of Public works is the responsible official for reviewing the FEMA accounts and all project accounts for Lupit and Sudal are now within the approved budgets as of September 30, 2005.



**FEDERATED STATES OF MICRONESIA  
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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2004-4  
CFDA No.: 84.027 – Special Education  
Grantor: U.S. Department of Education  
Area: Procurement, Suspension and Debarment  
Questioned Costs: \$12,446

Criteria: The State should ensure that competitive procurement determinations are documented in file.

Condition:

There were no competitive procurement procedures documented in file for the following expenditures.

APV #20792	\$3,545.00
APV #15285	2,577.44
APV #19267	4,861.90
APV #16018	1,461.50

Cause: The cause of this condition is inadequate documentation in support of competitive procurement decisions.

Effect: The effect of this condition is questioned costs of \$12,446.

Recommendation: The State should ensure that its competitive procurement determinations conform to the federal requirements.

Auditee Response and Corrective Action Plan:

- 1) APV 20792 - Payment by DOE (Special Ed) for used car. The former coordinator went to four vendors (YCA, 7D, PBC, and EMI) and only 7D had a used sedan available.
- 2) APV 15285 – Payment by DOE (Special Ed) to YCA for furniture and office supplies. Quotations from PBC, EMI and YCA with YCA the cheapest.
- 3) APV19267- Payment by DOE (Special Ed) to YCA for office furniture This procurement was done immediately after the typhoon; informal quotations were solicited from PBC, EMI, and YCA, but only YCA had stock available that had not been damaged by the typhoon.
- 4) APV 16018 – Payment by DOE (Special Ed) for flywheel assembly for the Spec Ed program vehicle that was undergoing repairs at the shop. This was an amendment to P13268 for which quotations were received from PTS, RAC, and PBC Auto shops, with PTS selected. Additional part was needed after repairs were started.
- 5) The purchase order for APV 15285 was approved by Spec. Ed Coordinator, Maria Waathan. The lack of approval on the APV was an oversight.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2004-4, Continued  
CFDA No.: 84.027 – Special Education  
Grantor: U.S. Department of Education  
Area: Procurement, Suspension and Debarment  
Questioned Costs: \$12,446

**Auditee Response and Corrective Action Plan, Continued:**

It is now the policy of the Yap State Government to require competitive procurement for all purchases, regardless of funding source. YSL 6-53, effective October 5, 2005 incorporates federal small procurement rules into Yap Law; three vendor quotes are required for all personal property costing less than \$5,000.

**Auditor Response:** The response appears to indicate that the State does not document its informal competitive procurement activities. We recommend that the State ensure that its corrective action plan is strictly followed.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Unresolved Prior Years' Questioned Costs  
Year Ended September 30, 2004

The following is a summary of unresolved federal questioned costs for the National Government.

	Questioned Costs Set Forth in Prior Audit Report <u>2003</u>	Questioned Costs Resolved in Fiscal Year <u>2004</u>	Questioned Costs at <u>September 30, 2004</u>
Unresolved Questioned Costs FY 99	\$ 57,860	\$ -	\$ 57,860
Unresolved Questioned Costs FY 00	75,221	-	75,221
Unresolved Questioned Costs FY 01	141,625	-	141,625
Unresolved Questioned Costs FY 02	582,927	-	582,927
Unresolved Questioned Costs FY 03	1,079,514	-	1,079,514
Unresolved Questioned Costs FY 04	<u>-</u>	<u>-</u>	<u>1,846,420</u>
	<u>\$ 1,937,147</u>	<u>\$ -</u>	<u>\$ 3,783,567</u>